The Development of the Financial Sector of Qatar and its Contribution to Economic Diversification

AL-GHORAIRI, ABDULAZIZ

The Development of the Financial Sector of Qatar and its Contribution to Economic Diversification

Submitted by Abdulaziz A Al-Ghorairi

The thesis is submitted for the degree of Doctor of Philosophy

Institute for Middle Eastern and Islamic Studies

Durham University, England

04/07/2010

Abstract

This study delves into the crucial question of how well posed the financial sector of Qatar is to contribute to the government's policy of economic diversification. In order to answer this question, the study focuses on analysing the sub-units that make up the financial sector such as banking, non-banking services and the insurance industry. The objective of that is to reveal the development and the contribution of these sub-units to the economy, as well as to elucidate the changes and constraints that these units face.

The Qatari government, through the accumulated oil and gas wealth, has been able to stimulate and support the development and expansion of financial sector services and this in turn has helped the economy to grow and private business to flourish. It is through the huge support that the government has provided that a nascent and diversified financial sector has developed in Qatar since its independence in 1971. So, within a very short span of time the country has moved from having virtually no domestic financial services to a situation where many types of banks have emerged: commercial, Islamic and specialised, as well as insurance companies and a stock market, not forgetting a variety of financial and investment companies that are starting to make an impact.

The study acknowledges the centrality of oil in facilitating the creation and the opportunities that allowed the sector to develop, at the same time acknowledging the constraints inherent in an economy that has a very small population and a large foreign workforce. This explains the decision of the government to create the Qatar Financial Centre, QFC, as a driver towards economic diversification and to spur financial sector development.

The study concludes that there are major challenges facing increased contribution of the financial services to economic diversification that necessitates, other than the focus on QFC, increased and substantial focus on the issue of GCC integration and cooperation.

Table of Contents

Chapter One: Introduction

Chapter Two: Literature Review

Chapter Three: The Structure and Role of the Banking System in Qatar

Chapter Four: The Expansion of Non-Banking Financial Services in Qatar

Chapter Five: Expansion of Insurance Sector and Emergence of New Financial Services

Chapter Six: Contribution of the Qatari Financial Sector to Economic Diversification

List of Tables

List of Charts

List of Boxes

Declaration

This thesis is my own work and has not been previously submitted for consideration for any other degree in this or any other university. Material from published and unpublished work of others is credited to the author(s) in the text

Statement of Copyright

Acknowledgement

I owe many people great debt of gratitude for facilitating the undertaking of this study, foremost among them is my supervisor Rodney Wilson for his dedication and support throughout the period of study. Thanks are also due to other members of the Institute of Middle East and Islamic Studies and the staff at Durham library and Middle East Document section.

I also owe thanks to all the interviewees for their time and effort, and invaluable contribution to the study especially the Minister for Finance and Economy of Qatar, Yousif Hussein Kamal; the Governor of Qatar Central Bank, Sheikh Abdullah bin Saud Al-Thani and Stuart Pearce, the CEO of Qatar Financial Centre. The staff of Qatar Central Bank and Statistics Department have been crucial in assisting in the gathering of the necessary data and information.

On a more personal note, I would like to express my appreciation to my family and friends for their support during my period of study.

Dedication

I dedicate this thesis to my family and friends

Chapter One

Introduction

1.1 The Significance of the Study

This study investigates the relationship between financial sector development and economic development in Qatar and the impact this relationship has on the country's policy of economic diversification. The literature on development broadly acknowledges the linkage between financial sector development and economic growth, due to the crucial role played by financial intermediaries in mustering huge amounts of savings and the utilisation of these savings in investments. The pattern of development of the economy of Qatar indicates that the development of the financial system of the country has been a consequence of the country's massive and sudden wealth due to the oil factor. In other words it presents an inverted relationship rather than the one mostly recognized in the literature on financial sector development. The importance of that to the current focus of the Qatari government on diversification of its economy relates to the question of how well posed this sector is to contribute to this policy as a source of growth, employment and income and how well suited government actions are in support of achieving such a goal.

Qatar is a very young and small state that has achieved massive strides in its socio-economic development since its independence in 1971. It has moved from an economy underpinned by basic economic activities to a wealthy oil-exporting state. The growth and development that accompanied the consolidation of its oil economy has been substantial considering its very small population. According to the 2004 census the population was put at 744.000, an increase of 42.5 percent on the previous census of 1997. A 2006 survey showed that the population had grown to 834,754, an increase of 12.6 percent on the 2004 census. However, recent estimates show that the total population reached 1,650,139 in 2009 (Qatar Economic Review, 2009). This rapid increase is due to the large influx of foreign labour to meet the needs of the expanding economy. Qatari nationals represent less than 34 percent of the total population. The country's per capita GDP exceeded USD 54,000 in 2006 and is forecast to reach more than USD 103,500 in 2009; one of the world's highest (Washington Times Global, June, 2010). Naturally, the small size of the population in relation to the massive size of its GDP is a factor in this.

This wealth has motivated the political leadership of Qatar to be extremely ambitious about putting Qatar on the world map, not just because of its oil and gas but as a financial, cultural and sports hub. Doha prides itself on housing the headquarters of Al Jazeera, the Arabic satellite broadcaster, and on successfully hosting the Asian games. It is preparing a bid to host the 2020 Olympics and 2022 football World Cup. What the Qatari state has achieved within a very short space in time is unique in terms of development, modernization and ambition. However, this has been led by the state and its oil and gas sector, which accounted for around 56 percent of GDP, 80 percent of export earnings and 70 percent of government revenues in 2007 (Qatar Economic Report, 2009). Such a pervasive role for the state sector necessarily means that the private sector is small and plays a limited role in the growth and expansion of the economy. Even the performance of the private sector and non-oil related activities have been linked to government expenditure programmes and intervention in terms of subsidized loans and input prices, equity injections, bailouts, and preferences in government procurements.

As a result of this overdependence on the energy sector, it has been difficult to develop many profitable investment opportunities outside the limited scope of real estate, trade and stock market activities. Consequently, there has been a concentration of banking lending activities mainly into consumer loans, real estate, construction and trade finance. Also, lending opportunities are further restricted considering the large proportion of the expatriate population whose access to bank credit is limited due to many government regulations.

The Qatari government is acutely aware of this dependence on oil and its associated challenges, as exemplified by the painful experience of 1982-86 when oil prices fell sharply. Qatar's gross domestic product (GDP) contracted significantly, and it took over a decade to pull its GDP up to its pre-oil shock (1981) level. This prompted the Qatari government to focus on a clear and ambitious strategy of economic diversification, in order to limit the effects of oil price fluctuations on its economy. This strategy was aimed primarily at developing its large reserves of natural gas for both domestic consumption and for export. Qatar has the third-largest reserves of natural gas in the world after Russia and Iran, and its North Field is the largest single non-associated gas reservoir in the world. This high-risk and high-cost strategy is bearing fruit. First of all, Qatar is the number one exporter of liquefied natural gas (LNG) in the world,, and since 2006, this has generated immense wealth for the country. Secondly, it has aimed at developing its non-energy sectors by using its energy wealth; a key part of this has been the development of the financial sector. The contribution to the economy of financial services has increased, mainly due to rapid growth in both 2004 and 2005, standing at a share of ten percent in 2008. In addition, Qatar embarked on a process of liberalization and privatisation of its economy as an integral part of its diversification programme towards decreasing the role of the state and expanding private interests. Its privatization programme included transferring of responsibility of the state-owned electricity and water corporations to an independent authority, and floating the controlling stakes of major state companies such as Industries Qatar, Qtel and Nakilat on the national stock market.

The ‘Qatar National Vision 2030’, published by the General Secretariat for Development Planning in July 2008, acknowledges the benefits of privatisation for the domestic capital market and the creation of market diversity and depth. Among the 'Four Pillars' on which the National Vision rests is economic diversification:

> The development of a competitive and diversified economy capable of meeting the needs of, and securing a high standard of living for, all [Qatar's] people for the present and for the future.

As part of its goal to achieve suitable economic diversification, the National Vision further recognises that:

> A diversified economy that gradually reduces its dependence on hydrocarbon industries enhances the role of the private sector and maintains its competitiveness.

However, this process of economic diversification is slow and gradual and is still linked directly to oil and gas wealth. Also, meaningful diversification involves not only privatisation, but also eliminating structural impediments and entrenched rigidities such as those present in the labour market and developing a financial market that can respond to local and regional needs and opportunities adequately. It also requires lessening its association with the wealth generated by the energy sector.

If Qatar's financial sector is to play a bigger role in its economy there is a need for that sector to have a regional focus, especially in light of the current collapse of the international financial system and its impact on investment opportunities. Qatar's domestic market is very small and private investment opportunities are limited; however, the Arab region provides ample opportunities which the sector can take advantage of.

Qatar Financial Centre (QFC) has been created as an instrument for attracting and supporting the operations of international financial institutions in Qatar by allowing 100% ownership, access to local business opportunities, repatriation of all profits and the opportunity to use the QFC and Qatar as a regional platform from which to expand and conduct business. By the end of 2007, the QFC had attracted and licensed a large number of firms from around the world representing the world's leading banks, insurers, investment houses, asset managers, legal firms, accountants, auditors and consultancies (Zawya, July 19, 2009).

Could this prove a hindrance rather than an enabling factor for the Qatari financial sector? Since the ability of local businesses to compete is restricted according to their expertise, size and sophistication, all of the firms licensed by the QFC are seeking to benefit from the massive investment in the region in infrastructure and business as well as the mega-projects planned for Qatar. These include the renewal of Doha's infrastructure and transport network, the expansion of national institutions such as Qatar Airways, as well as key projects such as the Pearl, Lusail and the new airport, all of which will create immense opportunities for the financial industry. The dynamics of opening up the economy to international business and developing a Qatari financial system is of great significance to the policy of creating a multi-sector domestic economy.

1.2 The Central Question of the Study

The main question this study intends to answer is the following: In a capital surplus economy like that of Qatar, where state revenues and state investments are the basis of that economy, is the financial sector limited in its role? A derivative question from this main one relates to the focus of government policy on the process of economic diversification; will this policy induce a bigger role for the sector in the limited domestic market of Qatar? In other words, what is the relationship between diversification and the enhanced role of the financial sector? In order to answer this question adequately, two main aspects were investigated in particular. The first relates to what has been the specific contribution of the financial sector to the Qatari economy, and the second relates to the role of QFC and the restrictions and challenges facing the sector as an essential part of the government's policy of economic diversification.

The contention of this study is that the growth of the Qatari economy, based on the hydrocarbon industry, generated and caused the expansion and increased demand on financial services. These financial services have been expanding in terms of type and size of activity, but considering the limited size of the domestic economy, their overall contribution to the economy remains limited, and their ability to significantly contribute to the policy of diversification is therefore limited too. The current strategy of the QFC; focusing on creating an environment for international players to engage in the region through Qatar is an acknowledgment of the limitations of the domestic financial market. However, this can be seen as contradicting the policy of diversification aimed at creating jobs for Qatari nationals in the private sector and away from the traditional public sector. These international players have no real interest in creating local capacity and imparting their skills and expertise. They are business entities that will be interested foremost in capturing the benefits for themselves.

For a sustained growth away from oil and gas revenues, therefore, the focus should also be on the regional economy and on increased cooperation among the Gulf States and for a speedier move towards economic integration. The GCC market is small compared with other markets in the world and the duplication of projects and/or institutions, especially in the industrial and financial sector, is not beneficial. Competition within the GCC market is not for the benefit of the long-term sustainability of these economies. The current global financial crisis adds a new dimension to this question in terms of a more challenging investment climate and lucrative asset classes, in addition to the obvious need that has risen to re-evaluate the role of the financial system in sustainable growth and the necessity for tighter control and regulation of the system.

Although Qatar has been in a position to limit the impact of the financial crisis on its banking system and to provide much-needed financial assistance to a number of national banks, it has shown that it is not immune to global events and its banking system is not as strong as was previously believed. Also, and most importantly, government assistance is essential for the stability of the banking sector. This creates more challenges to the government's policy of diversification and creates the necessity to reconsider the real potential that exists in the financial system to create employment opportunities and the generation of revenues within the Qatari economy. However, Qatar, as much as other Gulf States, has ample opportunities within the region, if its focus is turned from an outward-looking, global investing pattern to a more inward-looking, regional pattern. The Qatari financial system can stimulate regional economies and by doing that they themselves can move away from the one-sector economy.

1.3 The Objectives of the Study

Despite the importance of diversification and sustainable growth to all GCC hydrocarbon dependent economies, little debate and discussion has emerged within the region to investigate policy issues, challenges and opportunities associated with such an essential and ambitious policy for the development strategy of these countries. There is no doubt that economic diversification is the way forward for Qatar as much as for other GCC countries in order to facilitate a sustained non-hydrocarbon dependent growth. However, the movement towards achieving it has been slow, and thus a more informed debate needs to emerge within the region among its researchers, policy analysts and policy makers. This study is a small contribution towards such a debate and consequently its specific objectives are the following:

1. To fill a gap in the literature and stimulate a debate on the specific challenges facing Qatar in its diversification strategy by looking specifically at the financial sector - a priority sector in this strategy.
2. To contribute to the literature on the subject of the relationship between financial sector development and economic growth.
3. To consider the limitations or potentials that the sector faces in an increasingly competitive regional and international market, especially taking into consideration the current collapse of the global financial market and the lack of confidence in innovative financial activities.
4. To review the perceptions and outlook of policy makers in Qatar, regarding their vision of the possibilities and challenges facing the sector and the government's policy of economic diversification.

1.4 The Methodology of the Study

The study focuses on answering the question regarding the role of the financial sector in the oil economy of Qatar and the implications of that role to its diversification policy as well as to the literature available on the subject of the linkage between financial sector development and growth. For that purpose the study was aided by using a mixed approach of qualitative and quantitative methods of research. This is in line with other social research where “Most research does not fit clearly into one category or the other. The best often combines features of each.” (King, Keohane & Verba, 1994: p5)

The qualitative approach is a useful tool for exploring and providing insight into the development and prospects of the financial sector by conversing with policy makers, business people and top management in the sector. The quantitative approach, on the other hand, provides the relevant data and analysis indicating the pattern of development of the sector as well as specific measurements of financial sector development and its contribution to Qatar’s economy. The combination of the two methods provides valuable and rich material to unravel the dynamics behind the development of this crucial sector and its role in Qatar’s economic growth.

1.4.1 The Qualitative Method

The qualitative method is a tradition that encompasses complex and varied techniques of inquiry and theoretical frameworks as well as methods of data collection. Data collection procedures in qualitative research involve four basic types: observation, interviews, documents and visual images (Creswell, 1994). The research interview procedure is used in this study because it essentially provides insight from key figures in Qatar of the prospects of the financial sector in contributing to sustainable development. The financial sector, although small and limited, has expanded significantly in Qatar within a short period of time and the government is keen to encourage its further development. Thus, it is essential to probe into the views and the expert opinion of those involved in the management and policy making of the sector in order to provide an analytical and useful picture of the development of the sector by focusing the attention of these figures on providing answers to the questions of this study.

The research interview is designed for the purpose of improving knowledge and delving deeply into social science issues (Wengraf: 2001, pp3-6). It is a practical method of collecting information that allows access to many different groups and different types of information. Its major benefits are summarised as follows:

> Interviews are more flexible than any other research method. They can be used to extract simple factual information from people. They can be used to ask people about their attitudes, their past, present, or future behaviour, their motives, feelings and other emotions which cannot be directly observed. Interviews can explore each question or issue in as much depth or superficiality as they wish (*ibid*, p37).

There are different types of interviews, the most commonly used one relates to the level of formality and structure where interviews are categorized as structured, semi-structured or unstructured interviews. The structured interview is more like a questionnaire based on a predetermined and standardized or identical set of questions. The researcher reads the questions and records the responses on a standardised schedule, usually with pre-coded answers. The unstructured interview is more like a conversation, with no pre-determined list of questions and the interviewee is given the chance to talk freely in relation to a subject matter or specific area. In social research, most interviews fall in between these two extremes and are classified as semi-structured interviews (*ibid*). The interviewer has a list of themes and questions to be covered, although these may vary from one interview to another as may the order of questions. Also, the interviewer can seek clarification and elaboration on the answers given, which adds value to the research question and objectives. The semi-structured interview procedure is used in this research since it allows flexibility and room for improvisation while at the same time allowing the researcher to fully plan and prepare the questions (May: 2001, p120- 5). In this way, it can be more challenging than the structured interview since more discipline and creativity is needed in the session and more time for analysis and interpretation after the session (*ibid*).

The Research Interview Themes: One of the essential tasks in preparing for the semi-structured interview is determining the themes of the research that the interview will cover. This focuses both the interviewer and the interviewee in order to fulfil the objectives of the study. The main themes that are explored in this study are summarised as follows:

- The ability and suitability of the Qatari financial sector to fulfil the objective of promoting economic diversification.
- The obstacles and/ or opportunities facing Qatar's financial system, especially in light of increased regional competitiveness and the global financial crisis.
- The impact of the Qatar Financial Centre on Qatar's financial sector.
- The ability of the financial sector to generate employment for Qatari citizens and decrease the dependency on the hydrocarbon industry.

These themes determined the question and the choice of interviewees. The questions were formulated to take into account the use of three types of questions: open questions, probing questions and specific /closed questions, since each has its own advantages that enrich the collection of data (Grummitt: 1980). Open questions were designed to allow the interviewee to provide extensive answers and encourage them to reply as they wish and are worded like open questions but with a particular focus and direction. Closed questions were used to obtain specific information or to confirm a fact or opinion.

The Quota Sample: The researcher decided on the actual individuals to be interviewed by using the quota sampling technique. This has the disadvantage of not being truly random and consequently generalisation on the basis of the result is not possible. However, in this instance it fills the requirement of this research in that the objective of the conversations with the chosen interviewee is more about collecting data concerning their specific knowledge and management of the financial sector than the desire to make generalisations on the basis of the findings. In addition, this study is concerned with the specific case of Qatar and the link between the development of its financial sector and economic growth. It is crucial to converse with those organisations that have been the drive behind the sector and its growth.

The sample needed was relatively small in size as a result of the specific characteristics that were required. These were determined by the different organisational categories that needed to be interviewed as seen in Table 1.1.

Table 1.1. The Professional Category of the Interviewees in Qatar

Category	Organisation	Interviewee
Public Sector	Qatar Central Bank	Sh Abdullah Saud Al-Thani (Governor)
	Ministry of Economy and Finance	Mr Yousef Kamal (Economy and Finance Minister)
	Qatar Financial Centre	Mr Stuart Pearce (CEO)
	Qatar Investment Authority	Dr Hussain Al Abdulla (Executive-Board member)
	Qatar Financial Centre	Mr Jon Morton (Director)
Commercial Banks	Qatar National Bank	Mr Ali Shareef Al-Emadi (Group CEO)
	Commercial Bank	Mr Hussein Ibrahim Al-Fardan (Chairman)
	Al Khaliji Commercial Bank	Mr Tariq Ahmad Al-Malki (Chairman & MD)
	International Bank of Qatar	Mr George Nasra (Managing Director)
Islamic Banks	Qatar Islamic Bank	Mr Salah Mohammed Jaidah (CEO)
	Qatar International Islamic Bank	Mr Mohsen Moustafa (Deputy CEO)
	Al Rayyan Bank	Mr Adel Mustafawi (CEO)
Insurance Companies	Qatar Insurance Company	Mr Ali Saleh Al-Fadala (Executive VP)
Investment Companies	Investment House	Mr Ahmad Ismail Moussa (General Manager)
	First Finance	Dr Khalid Bin Ibrahim Al-Sulati (President)
Capital Market	Qatar Exchange	Mr Saif Khalifa Al-Mansoori (Market Manager)
Specialised Banks	Qatar Development Bank	Sh Hamad Nasser Al-Thani (General Manager)
Money Exchange	Al-Fardan Trading & Services Co	Mr Fahad Hussein Al-Fardan (President)
	Dlala Brokerage & Investment Co	Mr Waleed Jassim Al-Mossallam (CEO)

It was important for the sample to cover government officials, the banking sector, the non-banking sector and businesses. These organisations and their representatives were chosen based on their critical roles and their essential contributions to these organizations as policy makers, management and experts in the field.

Data Quality and Data Analysis: In the use of semi-structured interviews, a number of data quality issues may arise, including reliability of data, generalisation and forms of bias. The lack of standardisation in these interviews and the difficulty in making generalisations is one of the reasons why, in some quarters, the quantitative method is seen as superior to the qualitative method. Its standardised statistical data is perceived as reliable, if not necessarily valid, and closer to the methods of natural scientists. The researcher increased the reliability of the data collected primarily thorough preparation and readiness of the researcher on the understanding of both the organisation and the themes of the interview as well as an appreciation of the interviewee's expertise area. Another factor that ensures reliability is the level of information provided to the interviewee before the interview, such as the list of interview themes. This gave the interviewee time to prepare and increased the value of the information provided. The data collected was transcribed and grouped in accordance with the themes decided upon prior to the interviews. The manner in which the grouped interview data has been utilised is by embedding it in the body of the study in each relevant section.

1.4.2 Quantitative Method

The quantitative research tradition is associated with a number of different approaches to data collection. The most common are surveys and experiments, followed by analysis of previously-collected data such as official statistics. Structured observation is another method which involves the researcher recording observations in accordance with a pre-determined schedule and quantifying the resulting data. Lastly, is content analysis which involves the analysis of the communication content of media such as newspapers (Bryman: 1996, p12). In this study the main vehicle for the quantitative method focuses on analysing the collected data of official statistics from a wide variety of government agencies as well as the publications of the various institutions of the financial sector.

The Themes of the Data: Taking into account the objectives of the study the main themes of the data collected focused on the following areas:

- The relative strength of each financial intermediary and its contribution to the economy.
- The overall policy environment that the sector operates within, especially in relation to the diversification policy.
- The challenges of the larger role of the financial sector in the economy.

- The institutional and regulatory environment that the financial sector operates within and their appropriations to stimulating and strengthening economic diversification.

Quantitative Measurements: There are several measures to assess the development and deepening of the financial sector. In this study the focus was on the following measures:

- Data that assesses the development of each specific financial intermediary of Qatar: banking, non-banking, insurance, stock market etc.
- Measuring the contribution of the financial sector to the value added to the GDP.
- Measuring the contribution of the financial sector to employment.
- Presentation of the data in graphs, tables, and charts as appropriate to illustrate the relationship between financial sector and real sector development.

A variety of other secondary sources of data and information available in the public sphere in both Arabic and English, such as books, articles, reports websites, newspapers etc, were consulted as well as unpublished material including doctoral theses. The access to information in both languages facilitated the reach to a wide range of material that added value to the research and enhanced the quality of data analysis.

1.5 Structure of the Study

This study consists of seven chapters. Chapter One introduces the research question, the main contention of the research, research objectives, research method, as well as the structure of the research. Chapter Two focuses on the literature review and conceptual frame of reference of the research. The purpose of this review is to describe the studies already undertaken regarding this problem and position this study within the literature on the subject matter.

In order to make a judgment on where the financial sector of Qatar sits within the policy of diversification and its contribution to the successful implementation of this policy, Chapters Three, Four and Five treat each component of the financial system separately in order to trace and delineate its major features and assess its role in the economy. In Chapter Three the banking sector is discussed in terms of its structure and the role it plays in supporting private investments and the private sector in general. Chapter Four investigates the development of the non-banking financial system which is a recent feature of the development of the sector and an important one in terms of fulfilling the government's objective of expanding and consolidating the sector as part of its policy of diversifying the economy. This will include discussing the Doha stock market and bond market as well as the impact of the financial crisis on the activities of both markets, in addition to discussing the development of the private equity market. Chapter Five focuses on the insurance sector as well as the recent emergence of new financial institutions such as finance and investment companies and their impact on the economy. It will also include a detailed discussion of Qatar Investment Authority (QIA) as an essential component of reinvesting the oil and gas wealth, as this wealth has not moved into individual hands as much as it did for instance in Saudi Arabia. The government, through this fund, is ultimately the main investor and guarantor of the stability of the economy. Chapter Six rounds up the discussion by assessing the contribution of the financial sector as a whole to the economy and to the policy of economic diversification against three measures: contribution to GDP and lessening the concentration of the GDP in the hydrocarbon industry; employment generation and the expansion of the private sector. A discussion of the objectives and role of the Qatar Financial Centre is included as it is a fundamental part of the government's vision of the financial sector and its economic diversification strategy. Chapter Seven presents the concluding remarks on the findings of the study.

Chapter Two

Literature Review

2.1 Introduction

This chapter summarises and evaluates the relevant literature on the question of the role of the financial sector in economic development and focuses on identifying the core concepts of this issue. Marshall and Rossman refer to the need to review the literature so that one can describe the studies about the problem to date and position one's study and ground it within this literature. There are two interrelated dimensions to this literature review; one that needs to look specifically at the literature relating to financial sector development and another that should focus on the literature on Qatar, particularly its pattern of development. This allows for an in-depth and substantive approach to the discussion of the role of the financial system in the economy of Qatar. The significance of elucidating the relationship between financial systems and economic development lies in its implication for development policy and policy options available to governments in order to shape and influence the direction of development. In the case of Qatar, this is of importance in particular to the government policy of diversification of the economy and lessening its dependence on the oil industry as well as its focus on expanding the role of the private sector and the financial system.

The review reveals the paucity of studies specifically relating to Qatar. The Arab Gulf area has generated immense academic interest since its emergence into the centre of global economy due to the oil factor. However, the interest has focused on bigger states such as Saudi Arabia and Iraq and to a lesser extent on Kuwait and the United Arab Emirates. Also, the scope of the focus has been dominated by either the oil industry or regional politics. This has exerted immense constraints on the attempt by this study to formulate a relevant conceptual basis for Qatar's development and the impact of Qatar's financial sector on the economy. On the other hand it was an opportunity to investigate and evaluate what has been published on Qatar and analyse their conceptual underpinnings. In addition, this review will analyse the main aspects of the current thinking on financial sector development and pay particular attention to the issue of relating the literature to the specifics of the pattern of development of the Qatari economy.

The chapter reviews, firstly, the material published on Qatar with the aim of establishing the present thinking on the development of the country. Secondly, it deals with the most prominent theorization on the development of the Arab Gulf countries, namely the rentier approach and Khaldoun Al-Naqeeb's influential proposition on the development of the area, in order to establish if there are any useful or relevant concepts that can be utilised in this study about the pattern of development of Qatar that directly impacts on the study of its financial system. This will be followed by a review of the literature on financial sector development and its implications for economic policy options as it is relevant to the study. Fourthly, the chapter traces some of the recent studies that deal particularly with the banking industry in Qatar and, lastly, it positions the study within all of the above and produces a working conceptual framework.

2.2 The Literature on Qatar

Very little material is available that deals specifically with Qatar, although it is well covered in books and other published material that deal with oil and the Arab Gulf states. Also, the material published so far is relatively out of date and does not take into account the most recent substantial socio-economic changes, as the following discussion reveals.

Among the few writers that have worked on Qatar is the historian Rosemarie Said Zahlan. In fact she wrote a number of books on the Arab Gulf states tracing their rise from tribal, subsistence existence to modern states amassing economic power and wealth, such as *The Origins of the United Arab Emirates: A Political and Social History of the Trucial States*, 1978 and *The Making of Modern Gulf States,* *Kuwait, Bahrain, Qatar, the United Arab Emirates and Oman*, 1989. The focus in this review is on her book, *The Creation of Qatar,* 1979, (reprinted 1989) which concentrates on analysing the political and economic development of Qatar from as early as 1760 until the mid 1970s. She is concerned with the issue of social and political integration in a state that emerged from a society sparse in population and that accumulated massive wealth within a short period of time. Zahlan is particularly successful in exploring the central role played by the tribal leader, Sheikh Khalifa bin Hamad Al-Thani, as the focal point of the process of societal integration. She gives a detailed record of the problems among Qatari inhabitants and their neighbours during the early formative years as well as an extensive treatment of the independence of Qatar and its emergence into a modern state in the wake of the development of its oil and the transformation of its economy.

Zahlan acknowledges, at the end of the book, that the social and political changes brought about by oil income and the associated changes in the society and economy will help to enhance the role of Qataris vis-a-vis the central role played by the ruling family. She also indicates that the changing role of Qatari women and the new opportunities open to them to engage in a variety of professions: doctors, teachers, scientists, will bring tension to a traditional society ruled by the powerful Al-Thani family. She suggests that it will be crucial to the stability and prosperity of Qatar how the state and the ruling family adjust to these modern demands of democracy and equality. One can safely say that the modernisation tendencies of the current ruler, Sheikh Hamad bin Khalifa Al-Thani, have helped immensely in the past years to lessen these tensions and to create an environment that can be best described as non conflictual between the rule of Al-Thani family and the country's citizens.

The first work to be published that deals exclusively with Qatar and its economic development is Ragaei EL Mallakh's book, *Qatar: Development of an Oil Economy,* 1979, reprinted in 1985 under a different title, *Qatar: Energy and Development*. El Mallakh focuses on analysing, firstly, the main characteristic of Qatar prior to oil, before attending to the main focus of the book of discussing the impact of oil on the development of the country. Although El Mallakh claims in the reprinted edition that the book goes beyond the usual updating for a revised edition, the new book retains almost all of the information and analysis of the original book with very few additions in the sections relating to natural gas and international cooperation. He takes into account, in these two sections, the new developments in utilising the North Gas Field which holds the largest nonassociated natural gas deposit discovered so far as well as the creation of the Gulf Cooperation Council whose aim is to actualise economic and other benefits of regionalism in the Gulf and expand activities and programmes for coordinated cooperation on a multitude of issues.

In analysing the impact of oil on the rapid development of Qatar, he combines economic analysis with a generally descriptive style. He focuses on the manner in which oil revenues have been utilized and points to some failures on the part of the state in terms of development of its human resources. In his discussion of Qatar's industrialization policy he points to the early awareness on the part of the Qatari government of its dependence on a depletable source of energy and the need to diversify its economy and adopt very prudent expenditure programmes. In the section relating to money and banking, El Mallakh traces the financial development of the sector pre-oil and post-oil, and points to a peculiar feature in the development of the monetary management of Qatar where the field of operation of the central money authority was restricted. The Qatar National Bank (half owned by the government) acts as the principal channel through which government funds are disbursed and plays a pivotal role in Qatar's financial system. The reason El Mallakh gives for this unusual situation is lack of experience, and he indicates that in time the authority will perform all central banking duties. That is exactly what happened in 1993 when Law No. 15 created a Central Bank and gave it the power to act as the bank of banks.

The analysis of Qatar's international links is wide-ranging: from the structure of Qatari international trade to the potential of regional cooperation and integration. El Mallakh indicates that Qatar from early on had a regional perspective and outward-looking attitude; a view shared by other Arab Gulf states that recognised that some degree of regional integration would serve their economic development and their future. The idea of a Gulf Common Market and common currency materialised later through the Gulf Cooperation Council.

Also, Qatar was keen on regional cooperation that would go beyond the Arab Gulf, hence its support for the Arab Monetary Fund, as well as a host of other Arab league affiliates. Foreign aid and development assistance to the region and beyond has been substantial in terms of a percentage of its GNP, in the form of contributions to regional entities, such as the Arab Fund for Economic and Social Development, the Arab African Oil Assistance Fund, OPEC Special Fund and IMF Oil Facility, to name a few. Also its country to country assistance has been substantial and mostly directed at Arab countries. In recent years Qatar has retained all those early signs of interest in cooperation between Gulf States and the region as a whole, and remains a firm contributor to a number of regional affiliations. Also its awareness of the need to lessen its dependence on oil and its diversification policy has borne fruits over the years with the expansion in the development of its gas resource and other economic sectors.

Zuhair Ahmed Nafi's book, *Economic and Social Development in Qatar*, 1984, is similar in its treatment of Qatar to El Mallakh's with statistics and data that do not go beyond 1981. The focus is on each economic sector separately providing a description of its development and illustrates how the oil revenues have been disbursed and utilised in order to advance the development of Qatar. His discussion includes the oil sector, manufacturing and agriculture, social development (social services and infrastructure), foreign trade and the banking sector. As in the case of the previous books, Nafi provides a very useful background on Qatar covering a wide range of economic issues but without advancing any substantial treatise on the type of development, its challenges and its impact on the social structure of the society.

In comparison to the works discussed above, the work of Jill Crystal, *Oil and Politics in the Gulf: Rulers and Merchants in Kuwait and Qatar*, 1990, provides a different type of analysis and view. As the title suggests the book offers analysis of the effects of oil on domestic politics in both Qatar and Kuwait. Crystal provides, firstly, an overall analysis of the relationship between state formation and oil, and the impact of oil on power arrangements in both states. Then she offers separate discussion for each state - we are primarily concerned here with the part related to Qatar.

Crystal examines the shifting of power in Qatar due to the decline of the pearling industry and traditional merchant families and the rise of oil revenues in the hands of the ruling family of Al-Thani. She explains how the weakness of the trade sector and consequently the merchant community of Qatar, especially in comparison to the merchants of Kuwait or Dubai, has benefited Al-Thani. This made the ruling family - although riddled with internal differences and rivalries and some seriously-contested successions in 1949, 1960 and 1972 - the most important player in the formation, integration and modernization of the state. Crystal gives a clear and interesting depiction of the pre-oil social structure of Qatar and the interrelations among its major components: the ruler, his family, pearling merchants and pearling workforce. This structure on the eve of oil was seriously weakened by the crash of the pearling industry which left only two powerful merchant families in Qatar, Al-Mani and Darwish, while a large part of the population migrated. With such a weakened social structure, Al-Thani family were in a very strong position to take advantage of the oil wealth.

This increased wealth of the state gave the ruling family the ability to broaden its base through state institutions and the distribution of benefits among rival families and clans to secure loyalties and internal stability. The state used institutionalised arrangements to protect an enclave of non-oil private sector through protective nationality and commercial laws which restrict property and business ownership rights to nationals, in addition to giving grants of land, money and monopoly concessions. The benefits of oil trickled down to all social strata through the distributive policies of the state covering health, education, housing and employment. However, the ruler allowed ruling family members to infringe on the merchants' economic territory with increasing frequency.

This economic power also led to the centralisation of political power. The ruling family of Qatar depends on kinship for key positions in the state, thus politics and the political institutions are controlled through the family. The closest relatives share the highest state posts. Crystal touches on the shift in power arrangements and style of rule since Sheikh Khalifa bin Hamad took control in a bloodless coup against his cousin. He has been very successful in controlling the excesses of the family and widening benefits to Qataris. Crystal points to the challenges that Qatar faces as a result of the fast pace of modernisation and increased wealth to Qataris, but fails to elaborate on these challenges and how the ruling family might respond. Crystal's theoretical basis of the study rests on the rentier approach which will be discussed in more detail in the following section. Suffice it to say here that her historical analysis of the impact of oil is much stronger than any previous work done on Qatar and provides an in-depth analysis of the relation between the economy and power relations in the society.

In a recent article, Mehran Kamrava (2009) provides an insight into the current political situation in Qatar. He postulates the basic position of rentierism by analysing how the rise in oil and gas revenues has deepened the state's capacity in relation to society. In particular, it allowed the Emir, Sheikh Hamad, to consolidate his rule and to ensure the co-option of ruling family members and Qatar elites, and the spreading of wealth among Qataris in general. That ensured that civil society groups do not rise to mount a challenge to his benign rule, and most importantly, the factionalism of the ruling family had been contained. The promise of political reform and liberalisation helped widen the appeal and the support the Emir needed, especially in the initial period after taking formal power in 1995. Part of this appeal centred on the Emir's promise of political reform and liberalisation. The country held its first municipal council election in March 1999 and in April 2002 the country inaugurated its permanent constitution for which the Emir held a referendum. The draft constitution was approved by 96.6 percent of the 69000 votes cast.

This increased wealth of the state, according to Kamrava, gave Sheikh Hamad the ability to embark on a very ambitious program of modernisation focusing on widening the state's institutions while concentrating the decision making process in the hands of the few. The most significant of these institutions is Qatar Foundation for Education, Science and Community Development which was founded in 1995 as an umbrella organisation to push forward the state's agenda on the following three levels; education, science and community development, allowing the state the ultimate control over these crucial areas, as well as enhancing its transformative abilities. The community development has an international reach through its Reach Out to Asia organisation, in support of community and educational development in Asia. This is very important in lieu of the large population in Qatar from Southeast Asia. Sheikha Mozah has been the force behind this foundation giving it prominence and international recognition. Another important institution is Qatar Charity. It engages in domestic and international community service. Although the Charity is a non-governmental organisation, it had over the years developed a close relation with the overall policy objectives and agendas of the state.

Through state institutions, the Emir has been able to control the relation with the three most important social actors: the members of ruling family itself, the notable families and the religious establishment. Increasing access of ruling family members and Qatari notables to state's massive wealth and placing them in prominent positions in state institutions augment their vested interests in the status quo, thus giving the Emir enhanced political stability and power. The ruling family has been the major source of instability because of family feuds, and contested power transitions in 1949, 1960 and 1972. Besides enhancing access to state's wealth, Sheikh Hamad had taken two major institutional steps to alleviate the challenge from within the family and by doing so, consolidated his own rule. He firstly issued an Emiri decree changing the line of succession from "within the Al-Thani family to "male Descendants of Hamad bin Khalifa." Secondly, in 2000, he established the Ruling Family Council under his chairmanship and whose members he appoints. This council decides on the vacancy of the Emir post and thus have a very influential mediating role to play. With the creation of new state institutions for the purpose of placing the Emir's allies in positions of power and by populating the cabinet with highest number of ruling family members among the GCC states, the Emir ensures a firm grip on the reign of power.

Kamrava points out that, unlike other GCC states especially Saudi Arabia, the religious establishment of Qatar does not pose any real threat to Al-Thani family rule because, firstly, Qatar does not have an indigenous local clerics and religious leaders such as the case in Saudi Arabia or Egypt. Most of the clerics used to come from Saudi Arabia, but since the 1990s and as a result of tension with Saudi Arabia these started coming from Egypt, Syria, Yemen and Iraq. Given that they are on temporary resident permits, their political activism and radicalism is heavily curtailed. Secondly, the number of Mosques and clerics in Qatar is relatively very small and the Ministry of Awqaf administer control on Mosques' preaching by providing a list of the topics for discussion. Nonetheless, the state maintains a sensible and cooperative approach with the religious community.

Kamrava's analysis emphases the link that has been suggested by the rentier concept between state's access to massive oil and gas funds and its ability to determine the political and economic transformation of society with the least possible interference from society's different social groups. This by itself undermines the emergence of autonomous civil organisation and the development of democracy. This also explains how the Emir's initial push for political reforms stalled and as of today Qatar is still without an elected parliament and the appointed Shura Council is mostly pro forma. The real power lies with the Emiri **Diwan and the Emir's close circle.**

The discussion of this section clearly demonstrates the lack of studies that postulate a conceptual framework to the study of Qatar and its economy. They all have two things in common: the centrality of oil and the centrality of the ruling Al-Thani family to the process of change and development but without providing any conceptual principles and tenets to help facilitate the study of Qatar and its economy. Crystal touched on the concept of the rentier state as an underlying theme for understanding Qatar's economy and society, but as the following discussion will show, this concept is of a limited significance.

2.3 Theorization on the Development of Arab Gulf States

For such a crucial area to the world economy, it is of interest that the theorization on the development of the region, especially in comparison to other developing regions such as Latin America, has been very limited and restricted to a group of writers led by Luciani who propagated the concept of rentier development. Khaldoun Al-Naqeeb is of particular importance because he is from the region and is the only academic who attempted such a difficult task. The following is an elaboration to these two approaches.

2.3.1 Rentier Approach

This is one of the most recent and most common conceptualisations of the development of the Arab Gulf following the consolidation of oil as the underlying economic element in the region. A group of writers, following Hussein Mahdavy's conceptualisation of Iran and his attribution of a 'rentier' pattern of development to its oil based economy, borrowed the theme and applied it to the Arab Gulf states. These include Luciani, Beblawi and others in their seminal book, *The Arab State*.

According to these proponents, "rentier states" are defined as having economies predominantly relying on external rent, in this case oil revenues, which can sustain them without a strong productive domestic sector. This affects the state and its relation to society in two ways. Firstly, it creates allocative/distributive states in which the expenditure of the state sector is central to the functioning of the economy, stimulating services predominantly and creating various levels of rent-seekers rather than stimulating productive sectors. The consequence of that is a state separated from society, since it is not dependent on the surplus produced within the private economy. Gulf 'rentier' states have no taxation policy and services are free. Secondly and most crucially, the state is capable of maintaining legitimacy without democracy and traditional networks of tribe, family, and sect act as the most effective channels for the distribution of accumulated oil wealth.

This concept applies to all Gulf States since Hydrocarbon industry underlines their economies. For instance the dynamics of the socio-economic structure, the political forces and the distinguishing characteristics of the social relationship prevailing in Qatar and Abu Dhabi are comparable. The historical role these two coastal mercantile cities have played and the pattern of their development, economic growth and the evolution of their political systems, especially the system of government, have been influenced and powerfully shaped by the discovery of oil. They both possess shared traits, such as a weak merchant class that helped to concentrate power in the hands of the ruling families, and thereby aided the formation of the state. Rentier economics has enabled the state to maintain a mutually beneficial corporatist arrangement with selected social groups, therefore lessening the possibility of demands for radical political change and, by extension, for democratisation (Cantori, 2000). Their political and economic history, and their experience of over-dependence on the hydrocarbon sector to stimulate economic growth and diversification strategies is similar in that its effect on the development of the socioeconomic and the political institutions has been limited, even though there is considerable scope for progress and a higher degree of sectoral diversification.

The Rentier concept, therefore**, is** useful on a descriptive level to account for the type of economy prevailing in these societies. But it does not provide any conceptual and methodological tools for analysing these societies and does not account for the massive social changes as well as political ones that have been taking place in_these states. Also, the proposition about the relationship between state and society is problematic. The ruling families of the Gulf are not completely independent of the society, and their rule is far from being absolute. Political and economic alliances are extremely important for maintaining the legitimacy of these states, through sharing in the economic opportunities created by the vast oil wealth and participating in their power structures. They have also encouraged and supported the expansion of private activities and a diversification of their economies which, over time, will increase the influence of their citizens. The relationship between the resource abundance of the hydrocarbon sector in both states and its direct effect on the limited size and role of the financial sector and the potential of the private sector to contribute more to the development of political participation, economic growth and diversification strategies results is **also similar and limited.**

2.3.2 Khaldoun Al-Naqeeb

The other recent conceptualisation of the development of the region is introduced in Khaldoun Al-Naqeeb's influential book: *Society and State in the Gulf and Arab Peninsula*: *a different perspective*. It warrants special attention since Al-Naqeeb claims to present an alternative thesis to that of the 'rentier' approach or as he puts it; "a more comprehensive and preferable tool" for analysing the Gulf States. However, he is unable to disassociate himself from the 'rentier' concept, and accordingly he attributes a more central role to 'rentier' states than in other capitalist societies because of the importance of public expenditure. More importantly, he emphasises the authoritarian structure of Gulf States and blames their inability to produce an integrated development on that. He defines the dimensions of this authoritarian structure as follows:

> The modern, contemporary form of the despotic state...seeks to achieve an effective monopoly of the sources of power and authority in society for the benefits of the ruling class or élite. [Firstly it]... achieves this monopoly by penetrating civil society and transforming its institutions into corporate organisations which act as an extension of state apparatus. [Secondly]....it penetrates the economic system and

> attaches it to the state either by nationalisation (as in the other countries of the Arab East) or by extending public sectors to complete state bureaucratic control of economic life. [Thirdly]....the legitimacy of the system of government in it depends on the use of force (or naked power) and organised terror more than upon traditional legitimacy (Al-Naqeeb, 1990: p99-100).

This definition, which is central to Al-Naqeeb's argument, is problematic for several reasons. For one, democracy has not been the pre-requisite of capitalist development and historical evidence shows that capitalist development in Europe and other parts of the world took different routes. Japan is a prime example of the state and its bureaucratic organisation facilitating capitalist development. Gulf States are capitalist societies that are following state-led and oil-led development, in other words following their own route determined by the economic endowment. Also the use of force is not the only method of legitimatising rule in the Gulf States; economic benefits and a share in the massive oil wealth have been a much more important tool. To claim that civil society in these states is an extension of state apparatus because of the disproportionate dependence of citizens on the state is an extreme position to take. There is room for civil organisations and the private sector as well as citizens to press their demands, grievances and claims on the state. Perhaps in comparison to developed countries, civil society is curtailed and it might take longer for it to develop and for democratic institutions to emerge appropriately, but to deny its presence is a distortion of the reality of these societies.

The different stages that Al-Naqeeb attributes to the transformation of Gulf society are questionable. He indicates that the Gulf has moved away from the 'rentier' state, defined in particular as that period spanning the two decades of the 1950s and 1960s, to the 'authoritarian' state starting in the 1970s. But if one accepts the 'rentier' concept how can one suggest that the Gulf is no longer based on the production of oil and 'living off' rent? On all accounts, Al-Naqeeb, is in the end, unsuccessful in undermining the 'rentier' concept and in providing an alternative conceptual approach. However, he does provide a thought-provoking thesis and opens the door to a wider debate on the development of the Gulf States

As this section indicates there is little in terms of conceptual literature on the development of the Arab Gulf. This has the effect of limiting the debate and stifling discussion on the challenges and the future of the region. It also has significant implications for limiting the possibility of evaluating policy and reform strategies.

2.4 Literature on Financial Sector Development

As mentioned before, there are no specific theoretical or conceptual studies on the relationship between financial sector development and the economy in the Arab Gulf States. Thus the focus will be on the general tendencies of the debate on the influence of the financial sector on production, employment and economic development. The relationship between financial development and economic development has been well established and accepted in the field of economic development. The recent upheaval in the international financial market is but evidence of the strong connection between the two and it is this connection that has forced the US government to provide an unprecedented bail-out to Wall Street, worth billions of dollars, in addition to the billions being extended to commercial banks by European central banks, in order to avoid further damage to the real economy. This debacle will increase academic interest in the issue and intensify the need to understand the limits of liberalization and the limits of unbridled financial sector development.

However, before this debacle, the particular issue that has been of major concern in the recent literature on financial sector development has been the direction of the relation between the sector's development and the growth of the economy. The importance of that lies in its implications for development policy for developing countries. The debate centres on the crucial question that was posed by Patrick (1966) as to which sector - financial or real - leads in the dynamic process of economic development? He acknowledges that the direction of the relationship changes over the course of development but emphasises supply-leading finance where financial development can induce real innovation-type investment before sustained economic growth takes place. The encouragement of developing countries to deliberately establish and promote financial institutions reflects this belief in supply-leading relationships. However, he observes that as growth occurs, supply-leading finance becomes_less important and demand-following financial responses become more dominant. That is usually the case in highly-developed economies.

A number of influential empirical works have been undertaken since Patrick's proposition, giving substantial support to supply-leading finance and financial liberalisation. The work of King and Levine (1993) is an example of that. They developed an endogenous growth model featuring connections between finance entrepreneurship and economic growth, and stressing that the financial system is the lubricant for the main engine of growth; better financial services expand the scope and improve the efficiency of innovative activity and accelerate economic growth while financial repression slows economic growth. In other words substantiating that financial liberalization and non-government intervention in financial systems is necessary for economic growth.

King and Levine construct four indicators of financial sector development to use in their model. These include firstly, a measure of the overall size of the formal financial intermediary sector that equals the ratio of liquid liabilities to GDP and called this measure DEPTH of financial sector. Secondly, is the ratio of deposit money bank domestic assets to deposit money bank domestic assets plus central bank domestic assets, and called that BANK; the higher the ratio the more financial services and higher levels of development of the sector. The third and fourth measures relate to the levels of funds being provided to the private sector as opposed to the public sector or state owned enterprises and called that PRIVATE measure. The ratio of credit issued to private enterprises to GDP is called the Private/Y measure. Higher values in these two indicators indicate more credit going to the private sector.

At face value these two indicators seem to be very relevant and important but the assumption that more credit going to the private sector means more productivity enhancing financial services does not necessary follow in the context of developing countries. A large proportion of private credit is utilized in consumption-related activities or what would be classified as non-productive activities. So without specifying which private enterprises are gaining access to this credit it is difficult to assume that the credit is enhancing the productive capabilities of the economy.

The four financial sector indicators are studied against the four constructed measures of growth: the growth rate of real per capita GDP (GYP), the growth rate of real per capita physical capital stock (GK), the growth rate of everything else (PROD) and the ratio of gross domestic investment to GDP in order to measure physical capital accumulation (INV). King and Levine studied the relationship between these measures for 77 countries averaged over the 1960-1989 period and found evidence of strong correlation between financial sector indicators and growth indicators, that is to say that financial sector development causes growth, and concluded that financial development is strongly linked to economic growth.

This model does not take into account the various development objectives that different countries might be pursuing. It might be necessary for governments to intervene, and liberalisation might not be the most appropriate policy as was seen to be the case in some countries. For instance the reforms that Argentina undertook during the 1980s had dire consequences, while the reforms in Korea during the same period caused an expansion in non-banking financial intermediaries rather than the banking sector. Also, financial reforms do not always alter the flow of credit from the least efficient firms to the most efficient, especially in developing countries. Credit in many of these countries is given based on criteria rather than efficiency; personal attributes and influence play a large part. The fact that credit in some countries, after financial reforms, flowed to more efficient firms does not necessarily mean that this will happen in the context of all other countries. The literature on developing countries clearly demonstrates the huge differences within this group and how sensitive policies are to the specifics of each country. Policies do not translate equally across cultures, institutions and economies. The conclusion that a more developed financial system will foster improved productivity by choosing higher quality entrepreneurs and projects does not always correspond to the situation in developing countries. This might apply in developed countries where institutions are strong and firmly established and nepotism and favouritism and political influences do not carry the same weight as in a developing country.

The work of Jung (1986) is another example of evidence of supply-following finance. His empirical study was based on a time series of 56 countries of which 19 were developed, and used two measures for financial sector development. One is the currency ratio defined as the ratio of narrow money (M1) to demand deposits. A decrease in the money ratio indicates more diversification of financial assets and liabilities and more transactions carried out in non-currency form. The second measure is the ratio of broad money (M2) to nominal GNP (or GDP). This monetization variable shows the real size of the financial sector of a growing economy; the ratio increases over time if financial sector development is faster than the real sector and decreases if it is slower. Jung found evidence that supports supply-leading causality whereby financial sector development leads to economic growth in developing countries, while evidence pointed to the reverse causal relationship in developed countries. It is important to make the point here that the flow of money in an oil economy, such as that of Qatar, depends to a large extent on how much the government decides to spend rather than on the amount credit banks and other financial institutions make available to private investors.

The recent empirical work by Calderon and Liu (2003) is intended to improve on the existing literature by testing both the supply-leading and demand-following patterns of financial sector development by using data for 109 developing and industrial countries for the period 1960-1994. They employed two measures for financial development: the ratio of broad money (M2) to GDP; a higher ratio indicates greater financial intermediary development, and the ratio of private sector credit to GDP; a higher ratio of bank credit to the private sector indicates a greater financial intermediary development. The results supported previous works in that financial sector development enhances economic growth but they also found evidence that the causality is bi-directional supporting both the supply-following and the demand-following patterns; financial development promotes growth and growth propels financial development. Lastly, the study found that the longer the sample interval, the larger the effect on financial sector development. In other words it takes time for the financial sector to impact on the real economy.

It must be stressed here that the advocacy for financial sector liberalization in developing countries was underpinned by the process of financial innovation and deregulation in the US, United Kingdom, Japan and other developed countries during the 1980's and 1990's. It is of interest, considering the present climate, to quote Merton H. Miller, who was awarded the Nobel Prize in Economics in 1990, regarding the absolute belief in the free market as a way of organizing the financial sector with no interference from governments. He says:

> The regulatory apparatus designed to protect the banking system actually becomes counter-productive and leads to a credit freeze-up wherever any substantial number of banks go bad at the same time. The US, to its great benefit, has made itself much less vulnerable than in the past to credit crunches (and has substantially increased the efficiency of the capital allocation process) by substituting dispersed and decentralised financial markets for banking (Miller: 1998, p14).

The current credit crisis will undoubtedly influence the position of the proponents of liberalization considering the unprecedented intervention that has been required on the part of central banks and governments in the US and Europe to stem the tide of the meltdown in the financial system. If anything, the crisis exemplifies the utmost necessity of the wisdom of a balance in regulation and control by the government over the excesses of the free market. Neither the banking system nor the financial markets can operate in a deregulated environment without the supervision and control of governments. The results could be catastrophic especially in a highly intertwined and globalised market.

In contrast to the above works, some argue there is little to support the argument that finance is a leading sector in the process of economic development. They warn of the dangers of inferences based on cross-section country studies which treat different economies as homogenous entities and warn of the blanket policy bias that these studies imply for advocating financial liberalization and overall liberalization of the economy in order to achieve long-term economic growth. The work of Demetriades and Hussein (1996) falls into this category.

They examined the causality relationship for 16 countries that were chosen according to specific criteria which included countries with rich experience in relation to both economic and financial development. They used two measures as proxy to financial development. The first is the ratio of bank deposit liabilities to nominal GDP, instead of broad money to GDP. Their rationale is that the rising ratio of broad money may reflect extensive use of currency rate rather than a rise in bank deposits. The second measure is the ratio of bank claims on the private sector to nominal GDP to assess the supply of money to the private sector which is ultimately, in the liberal economy model, responsible for quantity and quality of investment and in turn for economic growth.

The result of this empirical work found little evidence to suggest that the financial sector is the leading sector of economic development and most of the evidence they found points to a bi-directional relation between development of the financial sector and economic growth. This bi-directional relationship was mostly evident in countries where successful financial sector reforms were carried out. In other words, reforms are able to contribute to the process of financial deepening and also to general economic development. They emphasised the fact that the results were very much country specific and warned that ‘there can be, therefore, no “wholesale” acceptance of the view that “finance leads to growth” as there can be no “wholesale” acceptance of the view that “finance follows growth**’.** In other words the relationship between the financial sector and the economy is more dynamic and varied than the literature suggests.

For developing countries there is also an important issue which is neglected in these empirical works and that is the relationship of financial sector development and poverty reduction. Although this is not relevant to oil-rich Qatar, this aspect undermines the strength of the overall work conducted on the subject of financial development and economic development. As evidenced by the problems and challenges facing large numbers in the developing world, economic growth alone is not a guarantee that benefits trickle down to all segments of the population, especially the poor. So policies that can improve access of this large portion of the population are as important as the emphasis on reforms for the liberalisation of the financial system. These reforms need to take into account the large bankable population that the financial system does not reach adequately. Although semi-formal channels such as microfinance institutions are provided for the poor, these are limited in access and scale of provision. Thus a widening in the formal sector provision of services can have a beneficial impact on the whole economy.

2.5 Literature on Qatar’s Banking Industry

This section analyses some of the recent literature that specifically deals with Qatar’s banking industry. Most of these reports are related either to the micro-aspects of the banking system such as the competitiveness of banks in Qatar, penetration of technology in the banking system, customer satisfaction levels etc., or related to the state of Islamic banking in Qatar. The reason for the relative dearth of academic research on Qatar’s banking system could be the government’s dominance of the banking sector and the slow implementation of reforms related to the sector. This section also analyses some research literature related to the monetary affairs of the country as the monetary system and banking system are very closely related.

Al-Muharrami (2009), in his study of the banking system of Qatar concludes that the banking sector in Qatar is highly concentrated. He also advises that the country's Central Bank should exercise great caution in allowing mergers between the existing banks and should take measures to induce the small banks to grow faster. The author arrives at this conclusion using the 'H-Statistic' (Panzar and Rosse, 1987) which studies the market structure of the industry using two popular measures – k-bank concentration ratio and Herfindahl-Hirschman index. The high concentration of banks resembles a monopolistic structure. This is an important observation which could have far-reaching implications on the economy as a whole as the monopolistic structure of the banking industry could lead to collusion between banks and could subsequently affect the dynamics of economic growth. Al-Sowaidi and Darrat (2006) point to the fact that Qatar National Bank, the partly government-owned bank in Qatar, accounts for about half of the country's total bank deposits. However the authors acknowledge that Qatar Central Bank openly encourages competition and has carried out a number of reforms in recent years to facilitate entry of private and foreign players into the industry. They also note that Qatar lags behind Bahrain in the 2006 Index of economic freedom published by the Wall Street Journal. The authors attribute the sharp increase in total deposits to GDP ratio from the 1980s to the 1990s to the change in policy of the government regarding the reformation of the banking sector.

Murjan and Ruza (2002) studied the Arab Middle Eastern banking industries during the period 1993-1997, using the same Rosse-Panzar test that Al-Muharammi used later. The authors concluded that the entire region had been operating under conditions of monopolistic competition. Thus it could be stated that conditions of restricted competition are found not just in Qatar's banking sector but are common in every Middle Eastern country. More importantly, the research identified two economic spectrums in the Middle East and concluded that banks in oil-producing economies are significantly less competitive than those in non-oil countries. As an economy which draws the majority of its revenues from oil-based businesses, Qatar can be deduced to have a banking system which is inherently less competitive and less efficient than its counterparts in non-oil economies. The authors attribute this lack of competitiveness to very tight regulatory policies followed by the government and poor implementation of reforms. Ariss et al. (2007) conclude, on the basis of non-parametric frontier approach, that the banks in Oman, Bahrain and Kuwait are the most efficient in the Middle East region. Qatar is found to be one of the least efficient with only Saudi Arabia having banks with even worse efficiency.

Al-Sulaiti et al. (2001) point to the dearth of academic research in the subject matter in their research on levels of customer satisfaction in Qatar's banking industry. The authors found through their primary research that, in spite of the implementation of reforms which have allowed foreign banks to open branches, the service quality in the banking sector in general is below expectation. The authors state that "the customers were less satisfied with all attributes related to pricing dimensions". Dissatisfaction was particularly rampant with respect to banks' interest rate policies, commissions and fees. The dissatisfaction of customers with respect to the fees charged is a direct fallout of monopolistic competition. Due to lack of competitive pressures, the fees for banking services have remained artificially high.

The significant role played by the Government in the monetary and banking policies in Qatar is examined by Abdulrazag et al (2003). The authors use Johanssen procedure to study the reaction function of Qatar Central Bank. The authors conclude that "money supply, prices, real income, government expenditures and international reserves share at least one long-run relationship". In the short run government spending is found to play a very important role in Qatar's money supply fluctuations.

Brown (2003), in his research on Islamic banks around the world, identifies that the Islamic bank concentration ratio in Qatar is higher than in most other countries with a value of 7.5 in 2001. The author shows that this ratio has declined only marginally since 1998 when it was 8.0. Two economies with a close resemblance to that of Qatar, the UAE and Bahrain, have an Islamic bank concentration ratio of

5.5 and 2.1 respectively. The report shows that there have been only two Islamic banks in the country and they hold average ranks in comparison to their counterparts in other countries with respect to structure, profitability, efficiency and liquidity. Qatar’s lagging performance in Islamic banking could be an important detrimental factor in future as Islamic banking is expected to gain a significant share of the banking business in the Middle East.

Awad and Al-Sowaidi (2000) analyse the effectiveness of monetary and fiscal policies in Qatar’s economy using a reduced form equation. The research shows that fiscal policy variables are more closely associated with economic growth than monetary policy variables. The authors point to the fact that the reason for relative failure of monetary policy could be the delay in publication of monetary data. More specifically, data such as GDP and inflation used to be published with a lag of one year until about 2006 when Qatar finally decided to join IMF’s data initiative. The authors also believe that the role of monetary policy will become more important in future when strong financial institutions emerge. El-Mefleh and Shotar (2008) delineate the theoretical structure of factors that determine the economic growth of Qatar. According to their conclusion, monetary policy shocks have a very limited impact on the economic growth of Qatar even during the long term horizon. This conclusion appears to be in line with that of Awad and Al-Sowaidi.

2.6 The Conceptual Framework of the Study

Considering the above discussion, any conceptual proposition regarding Qatar must take into account the centrality of the hydrocarbon industry and state revenues to the economic, social and political structures of the country. That does not mean that the relationship between state and society is static as implied in the rentier approach or that the state is all-powerful as suggested by Khaldoun Al-Naqeeb and the rentier approach. It simply means a different relationship exists than that seen in many capitalist countries where state revenues are primarily extracted from private enterprises and used to provide national security, infrastructure and social services, and where there is a clear line of accountability to the government through parliament. It is beyond the objectives of this thesis to elucidate the dynamics between state and society in Qatar but suffice it to say here that financial sector development has occurred within a particular economic dimension dominated by the hydrocarbon industry and unprecedented levels of revenues concentrated in the hands of the government.

In such an economy, development depends on government budgetary policies while the flow of money in the system depends on the extent to which the government decides to spend from its oil revenues. This particular relationship has triggered little interest among those studying the Gulf and no particular work exists either on the Arab Gulf region or a specific state within the region to illustrate and analyse this. The development of the Qatari economy and other Arab Gulf states, in no small measure, challenges the position extensively covered in the literature of financial sector development that the sector is the engine of growth and development in a modern society. What has been the engine of growth in these states is the massive revenues accruing to the state that allowed it to become a major employer, investor and provider of infrastructure and social services, in addition to its control of the dominant economic sector: the hydrocarbon industry. The growth of these economies has been staggering by any measure and the dominant role of the oil industry means the government, its enterprises and various institutions have a huge influence on the economy, leaving a small private sector in some countries such as Qatar.

This study consequently takes the view, following Demetriades and Hussein, that any discussion has to be, foremost, country specific. This is because the type of economy and its institutions, public and private, impact directly on the development of the financial sector. Thus the particularities of an oil economy have influenced and shaped the relation between public and private sectors and the role of financial institutions. In addition to this, within this group of countries, individual countries exhibit different patterns and levels of development. For instance Qatar's financial system is a late developer compared with those of Dubai, Bahrain or Kuwait and the role of its financial system is not as extensive.

The bi-directional approach is the most appropriate way of looking at the relationship between the economy and the financial system. In Qatar, state revenues, expenditures and the predominance of the oil industry have been the main impetus behind the development of its financial system. This is the case for all the GCC countries. They have created the most developed financial markets in the Arab world but this has been to a great extent a function of high oil prices and great wealth. The unprecedented expansion and growth of the Qatari economy over a very short period of time created a demand for a variety of financial instruments and subsequently the banking and financial system witnessed substantial changes and development. If the critical question of which sector, financial or real economy, led the process of economic development, the answer is undoubtedly the growth of the real economy led to changes in the financial system of Qatar, supported and encouraged by the government.

However, this has implications for the strategy of economic diversification since, without the revenues of oil and gas, the non-oil economy is not strong enough to generate sufficient business to maintain the financial sector. In that lies the big challenge of diversification strategy of Qatar as well as other GCC countries. This study will demonstrate this situation clearly. It will provide the evidence of financial sector development and growth in Qatar, yet its influence on the economy in terms of contribution to employment and GDP and thus to diversification policy is still very small. The measures that the study utilises to assess the development of the financial system are defined on two levels, firstly, the economic indicators which include 1) the range of financial services that is available, 2) the diversity of institutions that are operating in the financial sector, 3) the amount of money that is intermediated through the financial sector, 4) the amount allocated by financial institutions to private sector enterprises and more importantly to what type of private enterprises. The second measure relates to assessing the regulatory framework and stability of the financial sector. This aspect has been given added significance as a result of the global international credit crunch and the substantial difficulties the financial sector is facing in the US and Europe and other parts of the world. Although the Qatari government does face similar difficulties, the crisis puts the policy of liberalization of the financial system under scrutiny. It shows how the globalisation of capital and capital flows can have serious adverse effects if the regulatory frame is not sufficient. This is quite a warning for newly-emerging financial centres such as Dubai, Shanghai, Bombay and Doha. Also the crisis is showing how, with the absence of an overarching European regulatory framework, the piecemeal approach in Europe is putting more strain on the system. That should give the GCC a push towards creating an overarching framework for their countries to avoid any such problems in the future.

Chapter Three
The Structure and Role of the Banking System in Qatar

3.1 Introduction

Qatar has been one of the fastest-growing economies in the world during the last decade. The nominal growth rate in GDP in 2008 was 44 percent, preceded by 25.1 percent and 33.7 percent in 2007 and 2006 respectively (Qatar National Bank: 2009). The GDP per capita was USD $103,500 in 2008, making it one of the wealthiest countries in the world (Washington Post Global: 2010: 27 June). Its massive base of oil and gas has provided a solid basis for its economy and, unlike Dubai, it is less leveraged, has fewer special flows or mass tourism, hence is less integrated in the global economy, putting it in a stronger position in this current challenging financial environment. However, this high dependency on revenues from the hydrocarbon industry has pushed the government to pursue a vigorous policy of diversification to alleviate the pressure of depending entirely on that one sector.

An essential part of this policy has been to encourage and support the development of its banking system and use it as a channel through which liquidity is provided to the private sector and the emerging businesses in the country, away from the oil and gas sectors. Sectors that were barely on the horizon a few years ago, such as real estate and construction, have become major drivers of growth. The purpose of this chapter is to ascertain to what extent the banking sector has been successful in aiding the diversification of the economy, as well as to investigate the impact of the current global financial crisis on the sector.

The chapter delves firstly into the development of the banking system by enquiring into its evolution and structure, the economic performance of the system and the relative positioning of the various participants as well as the challenges that are facing the system in light of recent government efforts to help the ailing banks. This is followed by a discussion of the impact of banking on the economy and its ability to contribute to the diversification policy. The evolution and role of money exchange companies, which provide a significant service to the expatriate community, is also investigated. The analysis would not be complete without detailing the development and role of Qatar Central Bank as the ultimate institution responsible for the banking system and the financial system of the country in general.

3.2 Development of the Banking System

One needs to keep in mind that the development of banking and financial institutions in Qatar took place in the recent past from a low base, and was directly associated with political and economic events, namely the independence of Qatar and the catapulting of oil to a central factor in the economic development of the country. The first step taken by the Qatari government, after its independence from British influence, was its membership of the International Monetary Fund in 1972 and the approval given by the Ministry of Finance and Petroleum to the agreement between commercial banks operating in Qatar on regulating interbank operations and interest rates. That was very important in light of the absence of a national central monetary authority. Following that, events in the monetary regulatory environment and the growth of the banking system accelerated. The banking industry has evolved from being a conduit to public sector finance enterprises to a genuine provider of credit to private businesses and individuals.

Qatar’s banking sector has evolved into a mixture of domestic and foreign banks, and has seen the emergence of Islamic banks during recent years. Being one of the fastest growing economies in the world, Qatar has attracted a significant inflow of immigrants from around the world, and from South Asia in particular. On one hand, these immigrants have contributed significantly to the economic growth of the country, as strong consumption expenditure amidst rising inflation has been one of the reasons for the rapid progress made, and on the other hand the increasing population has stepped up the aggregate demand for banking services in the country. The government has responded to this demand by permitting the creation of a number of banks in recent years. At present there are 18 banks engaged in corporate and retail banking business. The government recently instituted Qatar Development Bank, a specialised developmental bank with the sole objective of providing credit to small and medium-sized enterprises. This is an area whose development will be significant in terms of income, employment and growth generation, and which constitutes part of the diversification effort of the government.

Traditionally, two cross-sectional groups of entities have contributed largely to the economic output – the oil and gas sector and the public sector. The government's policy to encourage the non oil and gas sector and the private sector to become significant contributors to economic development depended on the banks being at the forefront of implementation of this policy. Accordingly, the banks have responded by expanding credit to private businesses and by encouraging non oil and gas businesses to emerge and grow through easy credit. However, despite significant development in this sector, its role in the economy remains limited and is primarily concerned with trade finance, consumer loans and real estate activities. One important private sector, real estate, saw declines in line with the global slowdown and caused major problems to the banks. The government responded by setting aside over USD six billion for recapitalising the ailing banks.

The following is a detailed analysis of the major aspects of banking in Qatar. The section is organised into three parts: the first part discusses the evolution and the present structure of the banking system in Qatar. The second part throws light on the economic performance of the sector by looking specifically at banking sector assets, loans and advances, deposits and shareholders' equity. Finally the challenges facing the banking system are discussed with a particular focus on the recent government bailout of banks as a result of the global financial crisis.

3.2.1 Evolution and Structure of Qatar's Banking System

The evolution of the banking system in Qatar is quite different from that of many other countries. The need for banking that rose from the exploration and export of oil in 1949 was serviced, until Qatar's independence, by a mixture of foreign and Arab banks. Until 1954 the Eastern bank – known now as the Standards Chartered Bank - was the only bank operating in Qatar; it opened its first branch in 1950. The Qatari government felt the need to have more banks and so allowed the British Bank of the Middle East to open its first branch in the country. Subsequently another bank - the Othman Bank, which is now known as Grindlays Bank, opened its first branch in 1956. In 1957, The Arab Bank became the first Arab financial institution to begin operations in Qatar. Following this, the Qatari government encouraged other Arab banks to set up business in the country. In 1960 another Arab bank - the Lebanese Bank, which is now known as the Al-Mashrek Bank was given permission to open a branch. These banks served a fast-expanding economy with particular focus on servicing government needs and the oil sector.

During the mid-'sixties Qatar realised that the entire economy was almost wholly dependent on foreign banking institutions and the need to create national institutions was recognised. Subsequently, it encouraged the creation of a number of domestic banks, thereby strengthening the nation's economic assets. The first locally-owned bank was the National Bank of Qatar (QNB) set up in 1965. Half of its capital was subscribed by the government and the other half by Qatari merchants. Since its inception the bank has taken the place originally occupied by Eastern Bank as banker to the government. Following the post-1973 oil price hike the government granted permission to create new banks on a periodic basis, which has seen the total number of banks in the country grow substantially. At present the number of banks operating in Qatar stands at 17, with a total of 210 branches, the majority of which (202) belong to national banks, leaving only 8 branches belonging to Arab and foreign banks (Qatar Central Bank, Annual Report, 2008).

Qatar's banking system has gone through a process of evolution which has reflected the changes in the economy. In the initial stages the country lacked the means and the infrastructure for an indigenous banking sector to emerge, but with increased government wealth and increased awareness of the importance of creating an integrated national economy the dynamics of the banking industry has shifted in favour of domestic banks with an ever-increasing role in the economy. Thus the past few years have marked not only an expansion in the size of the banking sector, but also its activities, level of services and an increased involvement of the government through its Central Bank in the regulation, direction and control of the business in order to make it more efficient and competitive. At present, there are three types of banks operating in Qatar: commercial banks (national and foreign), Islamic banks and specialized banks. Table 3.1 shows the list of banks licensed and permitted to undertake banking operations in the country.

Table 3.1 The Type of Banks Operating in Qatar

Commercial Banks		Islamic Banks	Specialised Banks
National	**Foreign**		
Qatar National Bank	HSBC	Qatar Islamic Bank	Qatar Development Bank
Commercial Bank	BNP Paribas	International Islamic	
Doha Bank	Arab Bank	Masraf Al Rayan	
Ahli Bank	Mashreg Bank	Barwa Bank	
International Bank of Qatar	Standard Chartered		
Al Khaliji	United Bank Ltd		
	Bank Saderat Iran		

Source: The Banking and Financial System in the State of Qatar 2006, Qatar Central Bank

Commercial Banks: Commercial banks are the dominant type of bank in Qatar in terms of numbers and activities. As seen from the previous table the number of commercial banks stands at 13, comprising both national and foreign banks. However, the Qatar National bank (QNB) dominates the banking sector, accounting for more than two-thirds of total bank deposits. It has also established two international branches, one in London and one in Paris. The QNB and Doha Bank includes members of prominent Qatari families on their boards of directors. According to Stuart Pearce, CEO and Director General of Qatar Financial Centre, (QFC) the, "retail banking sector is oversaturated and no intention to allow retail banking activities to operate from Qatar Financial Centre", (Interview July 2008). The strategy of growth of commercial banks is, henceforth, focused on outward expansion by buying banks in other countries. This is very difficult for some banks as indicated by the Managing Director of the International Bank of Qatar (IBQ), "Not all banks have the option to expand outside Qatar; our bank does not have either the capital or the expertise to pursue such a growth strategy." (Interview July 2008). This is an area where government attention is needed to support local businesses in finding the best ways to remain competitive and to expand. Mergers and GCC integration is an important aspect in this regard.

Islamic Banks: Islamic banking operates under Islamic law (*Shariah*), which prohibits interest (*riba*) and runs under a variety of financial instruments including *Mudaraba, Musharaka, Murabaha, Qard Hassan, Ijara, Wadia and Takaful* (Box 3.1). The most used of these financial instruments are *musharaka, murabaha and mudar*aba - all have in common the basic principle of modern Islamic banking; interest is prohibited but profits are allowed. Although Islamic banking came to Qatar late in comparison with other states in the region, it quickly established itself as a player in the market. The first trialling of Islamic banking took place in Egypt in the early 1970s followed by Dubai and Kuwait. Qatar Islamic Bank was established in 1982 and has become the sixth largest Islamic commercial institution in the Gulf after the Kuwait Finance House. A second Islamic bank, Qatar Islamic International Bank was established in 1991 while a third, Masraf Al-Rayan was created in 2006.

The objectives of Islamic banks in Qatar are similar to all Islamic banks and include the following:

Box 3.1 Financial Instruments of Islamic Banking

Mudaraba: A unit trust agreement between a lender, the bank, and an entrepreneur, the *mudarib*. The lender agrees to finance the entrepreneur's project on a profit or loss sharing basis. The *mudarib* undertakes to pay back the capital invested and a share of the profits. The management is in the hands of the *mudarib*

Musharaka: A partnership for a specific business activity in which the bank and the partner create joint venture projects with the aim of making a profit. The bank participates in the management.

Murabaha: A resale contract where traditional lending is transformed into a sale and purchase agreement. The bank buys specific goods or commodities requested by the client and then resells them at a higher price agreed upon by both parties.

Qard Hasan: A loan without interest. The borrower is obliged to repay the lender the principal sum borrowed on the loan. It is left to the borrower to pay any sum over and above the amount of the principal. This instrument is usually used by the state and less wealthy member of society.

Ijara: Renting, a contract of lease or hire.

Wadia: An agreement to deposit an asset excluding land in the custody of another party who is not the owner such as a bank.

Takaful: Mutual support which is an alternative to western insurance. A number of participants agree to pay instalments to *a takaful* fund managed by an Islamic bank. The bank invests the funds in *halal* projects and pays the members benefits.

Source: Asyraf Wajdi Dusuki, *Understanding the objectives of Islamic Banking.* International Journal of Islamic & Middle East Finance & Management. Vol.1, issue 2. 2008.

1. To attract funds and employ these resources in financial instruments based on asset-backed trading contracts or equity finance with risk sharing.
2. To develop a saving habit among Muslims and achieve a balance between profit maximization and social responsibility.
3. To offer bank services that are profit/loss sharing rather than interest-oriented according to Islamic *Shariah* (Dusuki: 2008)

A most encouraging development for Islamic banking is the fact that while the international financial system has imploded this small but growing share of world capital has weathered the storm. This should be no surprise since the sector's lending model operates on the principle of rejection of interest payments and deliberately avoids speculation and heavy borrowing. In other words, the sector forbids the excesses that brought the Western model of financial system to the verge of collapse.

Not only has Islamic finance proved more prudent in light of the financial collapse, but its proponents say it provides a better way of linking the financial system to the real economy. Islamic banks maintain ownership of the asset until the loan is paid, so they have greater incentive to make sure borrowers do not exceed their abilities since the bank shares in the risks the entrepreneur takes. This helps to tilt the banks towards facilitating productive investment and ensuring that savings are used for useful ends. A leading figure in Islamic banking, Amr-al Faisal, explained that, "Our dealings have to be tied to actual economic activity, like an asset or a service. You cannot make money off money. You have to have a building that was actually purchased or a service rendered, or a good that was actually sold" (Washington Post: 2008).

The share of Islamic finance makes up only one percent of world finance suggesting tremendous room for growth. According to Majid Dawood, Chief Executive of Yasaar, a Dubai based *Shariah* finance consultancy, "We had expected to be at 12 percent of the global market by 2025, but now with this financial crisis, we expect to get there much faster" (*ibid*). Many Western banks have *Shariah*-compliant arms and laws are made to accommodate the different property transfers required for lending. Malaysia and London are growing as major centres of Islamic banking; however, the Gulf retains the biggest Islamic banks: Dubai Islamic Bank, Kuwait Finance House and Saudi Arabia‘s al-Rajhi Bank. Interest in Islamic finance is also growing among non-Muslims, because it is seen as more ethical. US Deputy Treasury Secretary, Robert M. Kimmet, noted that experts at his agency have been learning the features of Islamic banking (*ibid*).

The Islamic model is not immune to problems and is not a replacement for the Western model, especially as there are areas in which Islamic banking is prohibited from dealing, such as alcohol, weapons, gambling, tobacco, pork and pornography. Nonetheless, it offers an alternative model that has shown resilience in times of severe financial crisis, and lessons can be learned from its prudent ways. One must remember that the 15 percent annual growth in the sector since the 1970s is fuelled both by the oil boom and by demand for this particular model. People's anxiety over the Western model of finance will undoubtedly increase this demand further.

Specialized Banks**:** Qatar Industrial Development Bank (QIDB) was the only specialized bank operating in Qatar in support of the industry sector. The Bank was accorded formal approval under Emiri Decree No. 14, 1997, to commence operations in the same year. Its capital was QR 200 million and its shares were divided equally between the Qatari government and private investors. Its board of directors consisted of four representatives of the government, one representative of the QNB which is half owned by the government and three representatives from the private sector.

In 2007 a change in the legal status and principle activities of the bank took place by amending the bank's articles of association and changing its name to Qatar Development Bank (QDB). The scope of the bank's activities was widened to include a range of sectors: industry, tourism, education, healthcare, agriculture, animal resources and fisheries. The bank's ownership is now totally in the hands of the Qatari government which has injected it with additional capital of QAR 10 billion. To accommodate the new aims of the bank, new members with experience and expertise in the new sectors were incorporated onto its board.

The creation of specialized financial institutions has been popular in other countries in the Gulf especially in Saudi Arabia. The country has three different specialised credit institutions; the Saudi Industrial Development Fund (SIDF), the Agricultural Bank of Saudi Arabia and the Real Estate Bank. These institutions owned by the government provide medium- and long-term soft loans for private projects as well as administrative, financial, technical, and marketing consultancy services to help develop and enlarge the private sector and to diversify the economic base of the country. Through these institutions Saudi Arabia was able to disburse billions of dollars to industry, agriculture and housing with the effect of increasing private sector participation in the economy as well as significantly increasing the activities of Saudi commercial banks. They opened letters of credit to import machinery and raw materials and supported the needs of these projects as well as contributing to the economic diversification the economy. In comparison the QDB is still in its infancy. However it shares similar objectives which are as follows:

1. To contribute to the diversification of the production base of the economy by financing projects in a wide range of sectors: industry, tourism, education, health and agriculture.
2. To provide finance to small and medium-sized projects in the above-mentioned sectors from domestic, GCC and international sources, and act as a guarantor for lenders and guarantee the exports of these projects.
3. To establish companies on their own in partnership with companies in corresponding sectors who identify with the objectives of the bank.
4. To provide technical assistance to investors and evaluation and monitoring of approved projects (QDB Annual Report: 2008).

Table 3.2 shows the significant change in the size of the bank's capital through the injection of the QAR 10 billion by the government to enhance its role in supporting small and medium-sized private enterprises in a variety of sectors. It also shows the increase in the bank's profits from a mere QAR five million in 1999 to QAR 144 million in 2008.

Table 3.2 Shareholders Equity in Qatar Development Bank 1999-2008 (QAR million)

Items	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Capital	150	200	200	200	200	200	200	200	1500	2900
Additional Capital	-	-	-	-	-	-	-	-	10000	10000
Legal reserves	2	3	5	7	9	11	11	14	18	40
Other reserves	6	11	11	39	75	90	125	114	100	50
Retained profits	5	6	8	16	25	31	31	45	61	144
Total shareholder's Equity	164	220	224	262	309	331	337	373	11679	13133

Source: Qatar Development Bank Annual Report 2008

Table 3.3 clearly indicates the expansion in credit facilities from a modest 13 million in 1999 to more than three billion in 2008. In that year the bank gave 54 capital loans and ten raw material loans. These loans were advanced for a variety of projects in the manufacture of food, beverages and tobacco; the manufacture of petroleum chemical, rubber and plastic products, the manufacture of non-metal products, machinery and equipment, fishery and animal industries as well as education.

Table 3.3 Qatar Development Bank's Balance Sheet 1999-2008 (QAR million)

Items	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Financial assets portfolio	3	78	80	117	141	170	212	212	212	186
Balances with banks & financial ints.	227	175	122	114	139	92	81	76	1	1
Credit faculties	13	24	30	39	57	72	99	105	1428	3245
Additional Financial Investments	-	-	-	-	-	-	-	-	10000	10000
Other assets	3	3	9	21	26	28	53	41	51	86
Total assets = Liabilities	**246**	**280**	**241**	**290**	**364**	**362**	**444**	**433**	**11693**	**13518**
Due to Banks & financial ints.	74	48	2	14	19	16	51	37	8	8
Customers' deposits	0	0	0	0	0	0	0	0	0	0
Provisions	1	1	2	4	6	11	13	7	0	0
Other liabilities	7	11	12	9	30	4	14	16	5	377
Capital & reserves	164	220	224	262	309	331	367	373	11679	13133

Source: Qatar Development Bank Annual Report 2008

It is evident from this expansion of the bank and the change of its status that the government is taking a more active role in support of the expansion of the private sector, especially small and medium-sized businesses, as an essential component in its diversification policy.

3.2.2 Economic Performance of Banks in Qatar

This section will analyse the performance of the banking sector in Qatar by focusing on the growth and utilisation of banks' assets, deposits and shareholders' equity, as well as the positioning of the different banks in the banking system.

A. Growth of Assets

Table 3.4 shows the total assets in the balance sheet of each bank in Qatar and the year-on-year percentage growth in total assets in 2008.

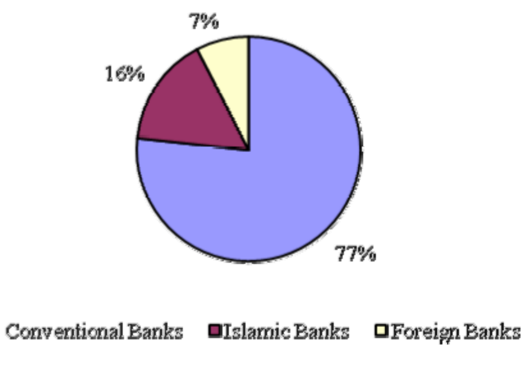
Table 3.4 Total Assets on the Balance Sheet for each bank in Qatar (QAR million)

Bank	2004	2005	2006	2007	2008	%
QNB	39548	50060	71663	114361	151974	33%
Doha Bank	10993	15230	21696	30058	39003	30%
Commercial Bank	12940	22182	30358	45397	61302	35%
Qatar Islamic Bank	7742	9552	14889	21336	33543	57%
Ahli Bank	4286	6181	9556	15576	17799	14%
International Islamic	4998	6336	8398	9951	12842	29%
International Bank of Qatar	2009	4660	6698	10771	22411	108%
Masraf Al Rayan			4324	10191	16769	65%
Al Khaliji				5151	12501	143%
Qatar Development Bank	352	432	392	1692	3518	108%
HSBC	3078	5004	6982	10284	14433	40%
Arab Bank	2130	2817	3895	4347	4988	15%
BNP Paribas	1650	1920	2358	2668	2882	8%
Standard Chartered	1392	1444	2287	4980	3716	-25%
Mashreq Bank	1264	1878	2006	2615	3092	18%
United Bank Limited	311	404	621	917	996	9%
Bank Saderat Iran	265	270	309	383	441	15%
Total	**92958**	**128370**	**186432**	**290678**	**402210**	**38%**
Conventional Banks	70127	98745	140363	223007	308507	38%
Islamic Banks	12740	15887	27611	41478	63155	52%
Foreign Banks	10090	13738	18458	26193	30549	17%

Source: QNB Capital (2009)

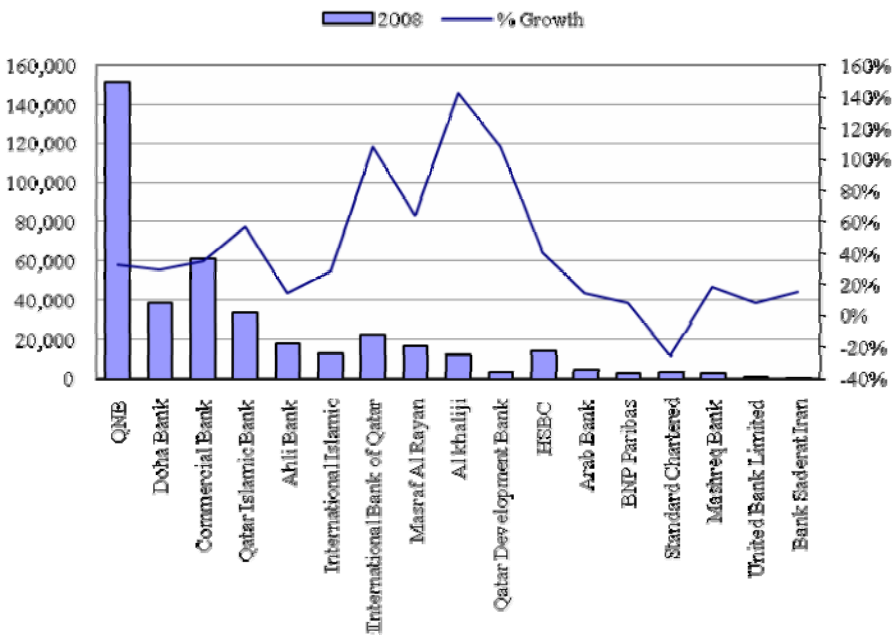
Displaying the data of the above table in Chart 3.1 shows that conventional banks account for about 77 percent of the total assets. Islamic banks occupy

Chart 3.1 Total Assets - Classification



the second spot with about 16 percent of the total assets. Foreign banks, in spite of being the dominant group in terms of number of entities, actually account for only seven percent of the Qatari banking industry's total assets. Chart 3.2 shows the bank-wise distribution of total assets in 2008 along with its corresponding growth rate over 2007 figures. It is evident that QNB is the biggest bank in total assets and is way ahead of other banks in the country. QNB's total asset base is about 2.5 times the asset base of its closest rival, Commercial Bank. Even though conventional banks account for more than three quarters of the total assets of the industry, Islamic banks have been the fastest growing category. The three Islamic banks – Qatar Islamic Bank, International Islamic Bank and Masraf Al Rayan saw growth rates of 57.2 percent, 29.1percent and 64.5 percent respectively. Besides the emergence of Islamic banks, there are a couple of important observations to be made on the basis of total banks' assets:

Chart 3.2 Total Assets (QAR million)



- It is observed that among the long-established domestic banks, those with a smaller asset base are growing faster than those with a larger asset base. There is an apparent 'size effect' visible in the emerging structure.
- The foreign banks have witnessed poor growth rates in spite of having small asset bases. Thus they have violated the size effect. The reason for this anomaly could be the restrictions placed on the foreign banks by the Central Bank of Qatar. In other words, the domestic banks, including

conventional and Islamic banks, are given legal and strategic advantages by the authorities and this has helped them to grow faster and stronger.

B. Loans and Advances

The primary function of banks is to take deposits and provide credit to the economy; bank credit is one of most important ways of providing liquidity to the economy and stimulating private business. Hence, it is essential to analyse the banks on the basis of their ability to perform their role as credit facilitators in the economy. This is not only important to a country like Qatar where its diversification strategy depends on banks' increased participation and the private sector in the economy but it is all-important in every economy. The following table (Table 3.5) shows the total amount of loans and advances lent by each bank and also the growth rate in their loans and advances in 2008 over 2007, while Chart 3.3 shows the distribution of loans and advances among the three categories of banks in Qatar.

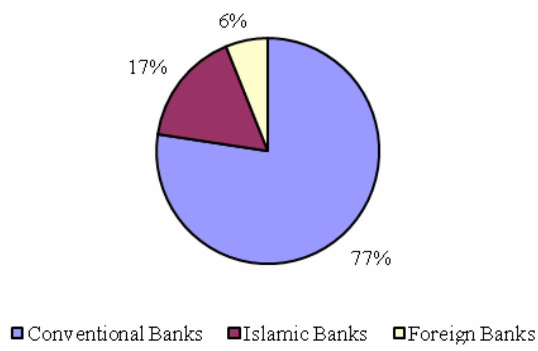
Table 3.5 Loans & Advances Lent by each bank in Qatar (QAR million)

	2004	2005	2006	2007	2008	%
QNB	26591	31478	46227	66064	100053	51%
Doha Bank	5437	8295	13630	19140	23966	25%
Commercial Bank	6714	10884	17360	25021	33898	36%
Qatar Islamic Bank	4263	5973	7156	11679	18866	62%
Ahli Bank	1445	3490	6294	10106	11547	14%
International Islamic	2621	3397	3620	4389	8253	88%
International Bank of Qatar	1009	2246	3754	6517	13177	102%
Masraf Al Rayan			187	6738	13326	98%
Al Khaliji				769	6980	808%
Qatar Development Banl	64	88	99	140	276	97%
HSBC	1614	2281	3111	5325	7137	34%
Arab Bank	1087	1756	2329	2537	2597	2%
BNP Paribas	672	931	774	1103	1067	-3%
Standard Chartered	609	586	1154	1187	1487	25%
Mashreq Bank	695	925	984	1843	1832	-1%
United Bank Limited	144	253	372	606	685	13%
Bank Saderat Iran	152	164	181	241	237	-2%
Total	53117	72746	107230	163404	245383	50%
Conventional Banks	41260	56481	87364	127757	189897	49%
Islamic Banks	6884	9369	10962	22806	40444	77%
Foreign Banks	4973	6896	8904	12842	15042	17%

Source: QNB Capital (2009)

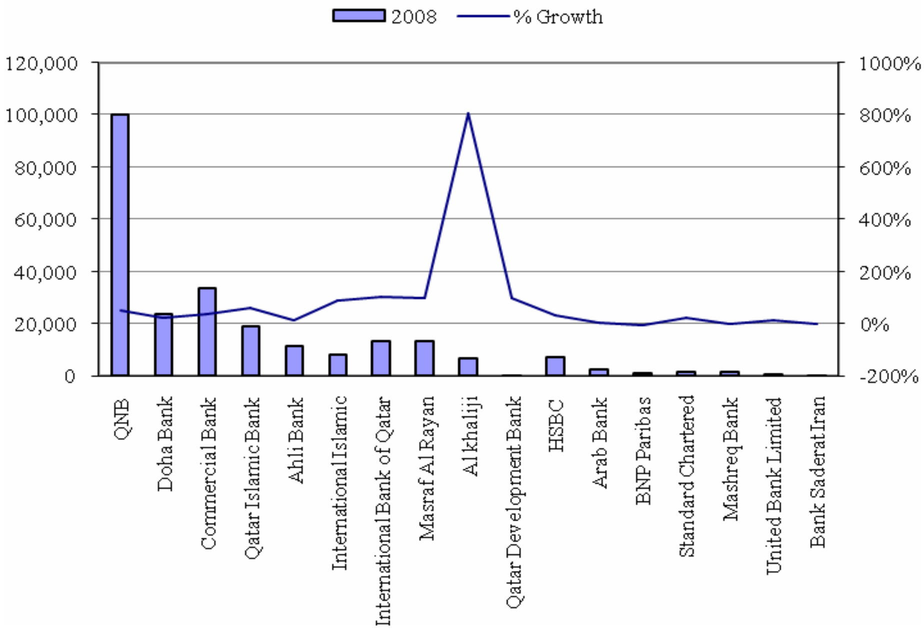
It can be observed in Chart 3.3 that conventional banks accounted for about 77 percent of the total bank credit provided in 2008 while Islamic banks had 17 percent of the total share of bank credit in the same year. Foreign banks accounted for just six percent. On the other hand, foreign banks with seven percent share of total assets took a six percent stake in the credit pie. This shows that the conventional banks have greater leverage in terms of their total asset base than the foreign banks.

Chart 3.3 Loans and Advances - Classification



On one hand this could be due to the more cautious approach exercised by the foreign banks or on the other hand it could be attributed to the rapid growth of Islamic banks which have eaten into the share of foreign banks. In 2007, foreign banks had a nine percent share in total assets and an eight percent share of total credit. In 2008 this shrank to eight percent of total assets and six percent of total credit. This could be seen as a positive development, giving the domestic banking system a greater role in the economy. The following chart (Chart 3.4) shows the total credit provided by each bank in 2008 along with the growth rate over 2007.

Chart 3.4 Loans and Advances (QAR million)



It can be seen that Al Khaliji bank had an extraordinary growth rate of 808 percent over the previous year, as 2008 was just the second year of operation for the bank. Qatar Development Bank also saw a rapid growth rate of 97 percent. International Bank of Qatar more than doubled its credit portfolio with a 102 percent growth over previous year. The dominance of Islamic banks is visible in credit too, with the three banks seeing an average growth rate of 77 percent. It can be seen that most of the foreign banks have witnessed much faster increases in total assets than credit. One of the reasons for this phenomenon could be the cautious approach undertaken by the foreign banks to consciously shrink their credit portfolio in response to their massive losses in their home countries.

C. Deposits

The prime source of funds for the banks is customer deposits. The following table (Table 3.6) shows the bank-wise break-up of total deposits collected from customers in 2008 and the growth rate in deposits over 2007.

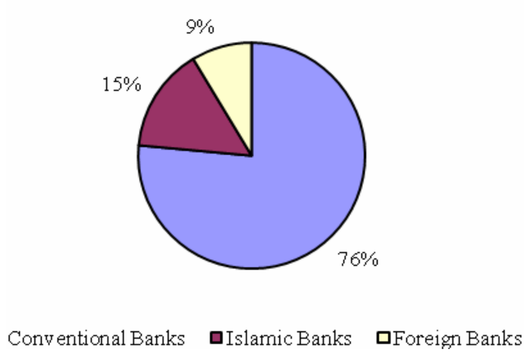
Table 3.6 Total Deposits for each bank in Qatar (QAR million)

Bank	2004	2005	2006	2007	2008	%
QNB	29614	36706	55767	79364	104253	31%
Doha Bank	8068	11049	15190	20043	23277	16%
Commercial Bank	8304	13235	17209	25796	32186	25%
Qatar Islamic Bank	5817	6866	8786	12201	16592	36%
Ahli Bank	2744	4530	6827	11494	12111	5%
International Islamic	4360	5077	6696	7218	9139	27%
International Bank of Qatar	1590	3586	4912	6952	11465	65%
Masraf Al Rayan			223	4943	10898	121%
Al Khaliji					4674	-
HSBC	2387	3925	5517	7508	10279	37%
Arab Bank	1700	2301	3275	3695	3718	1%
BNP Paribas	1114	1318	1788	1779	2222	25%
Standard Chartered	1039	1127	1863	1918	2232	16%
Mashreq Bank	870	1417	1303	1772	1641	-7%
United Bank Limited	247	317	513	736	829	13%
Bank Saderat Iran	198	194	223	284	287	1%
Total	**67970**	**91648**	**130090**	**185703**	**245802**	**32%**
Conventional Banks	50239	69106	99905	143649	187965	31%
Islamic Banks	10176	11943	15705	24362	36629	50%
Foreign Banks	7555	10599	14480	17692	21208	20%

Source: QNB Capital (2009)

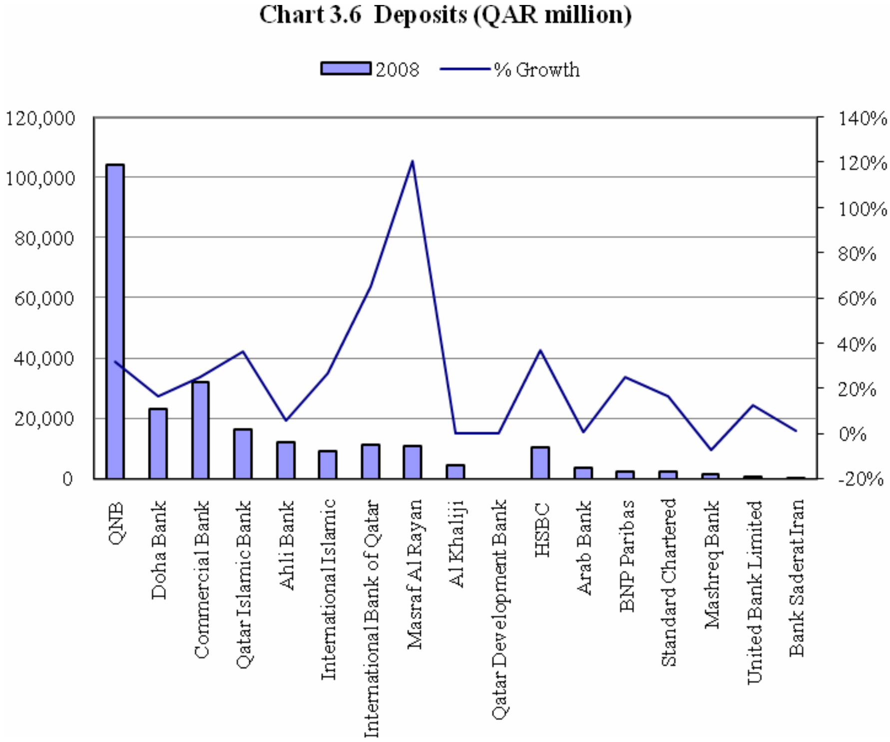
The following chart (Chart 3.5) shows the share of the three categories of banks in total deposits collected from customers in 2008. Once again conventional banks have over two-thirds share in deposits. Islamic banks have a 15 percent

Chart 3.5 Deposits Classification



share and foreign banks nine percent. Islamic banks, in spite of their 17 percent share in credit, have a 15 percent share in deposits. It could be that, because of their relatively recent foundation, the quality and range of services and products have not yet reached a level of competence to enable them to take a larger share of the market. Also, Islamic banking, because of its unique ways of functioning with respect to interest rates, appeals only to a particular type of customer. Foreign banks have a nine percent share in deposits to more than make up for their six percent share in advances. This once again shows the highly-cautious approach followed by the foreign banks in the wake of the global economics crisis.

The data can be better observed from the following chart (Chart 3.6). Masraf Al Rayan Bank was the fastest growing in 2008 in terms of customer deposits. Its Islamic counterparts, Qatar Islamic bank and International Islamic Bank, grew by 36 percent and 27 percent respectively during the same period. It can be observed that the domestic banks grew faster than their foreign rivals in 2008. This may be due to 'safe-haven' effect, *i.e*. customers preferring to park their funds in domestic and local banks during times of crisis (Dekle and Kletzer, 2001).



D. Shareholders' Equity

For banks, their equity capital is the factor that decides the scope of their business. This is due to the capital adequacy requirements of central banks around the world. The recent global crisis due to a real estate sector meltdown has also affected Qatar, and the banks have been under severe financial stress due to write-downs related to domestic real estate and construction sector exposures. The Qatari government's recapitalisation of top listed banks in the country to the tune of over USD 5.3 billion in October 2008 managed to meet the decreases in capital due to write-downs. The following table shows the bank-wise shareholders' equity in 2008 and the corresponding growth rate over 2007.

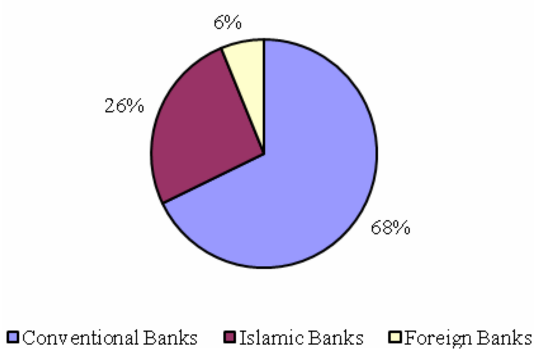
Table 3.7 Shareholders Equity for each bank in Qatar (QAR million)

Bank	2004	2005	2006	2007	2008	%
QNB	6685	8709	8457	13858	16643	20%
Doha Bank	1594	2401	2768	3619	4913	36%
Commercial Bank	2620	5677	5631	6228	9978	60%
Qatar Islamic Bank	1497	2096	4245	4629	7143	54%
Ahli Bank	890	1075	1182	1524	1640	8%
International Islamic	450	882	1425	2356	2780	18%
International Bank of Qatar	392	902	1367	1928	2593	35%
Masraf Al Rayan			4079	5159	5694	10%
Al Khaliji				4561	4546	0%
Qatar development bank	332	375	348	1679	3133	87%
HSBC	318	440	621	799	1081	35%
Arab Bank	178	239	355	448	567	27%
BNP Paribas	115	143	207	250	288	16%
Standard Chartered	156	190	165	191	377	98%
Mashreq Bank	333	395	657	733	1188	62%
United Bank Limited	61	78	95	120	127	6%
Bank Saderate Iran	57	60	69	78	119	52%
Total	**15676**	**23662**	**31671**	**48160**	**62812**	**30%**
Conventional banks	12121	18237	18388	31469	40854	30%
Islamic banks	1946	2978	9749	12144	15617	29%
Foreign Banks	1218	1545	2168	2619	3748	43%

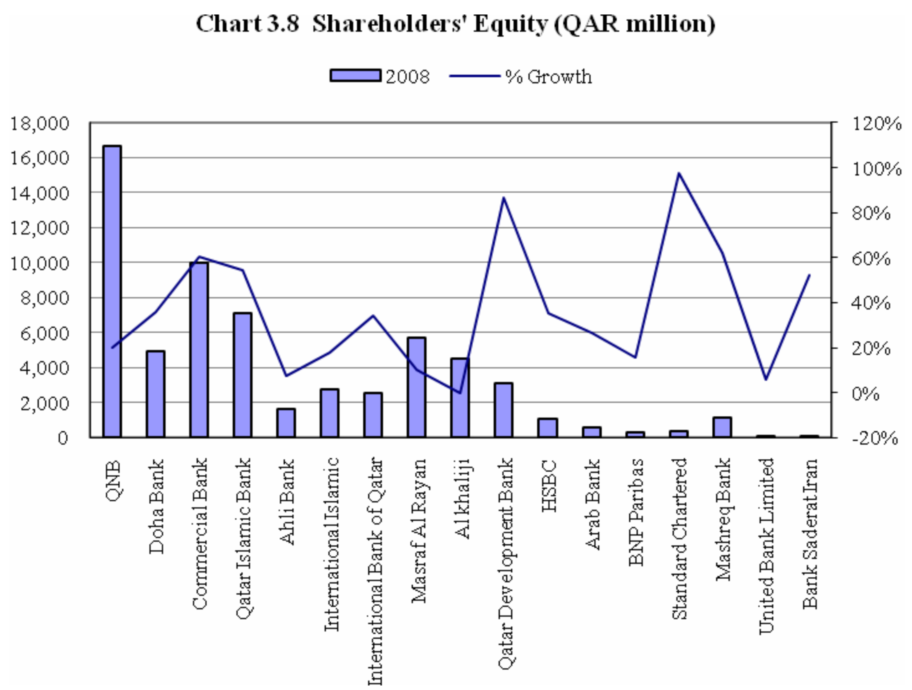
Source: QNB Capital (2009)

The following chart (Chart 3.7) shows the break-down of shareholders' equity in Qatari banks category-wise.

Chart 3.7 Shareholders' Equity Classification



Once again conventional banks, including the specialised bank, lead the pack with a 68 percent share in the total bank capitalisation of Qatar. However it has to be noted that Islamic banks are in the most comfortable position when comparing their equity with loans and advances. While they hold a 26 percent share in capital-base, their loans and advances share in the total pie is just 17 percent. Foreign banks have a six percent share in the total capital of banks. The following chart (Chart 3.8) shows the capitalisation of banks in 2008 and their comparative performance over 2007 figures.



One very important observation with respect to the capital infusion of banks in 2008 is that some foreign banks saw dramatic increases in capital in 2008. This could be part of their fresh capital infusion seen globally. Standard Chartered almost doubled its capital in 2008 with a dramatic 98 percent increase. Mashreq Bank also topped its capital up by 62 percent. It can be observed that Commercial Bank saw a 60 percent increase in capital which should place it in a better position to compete with its distant leader, Qatar National Bank. The Islamic banks also saw healthy doses of capital infusion in 2008.

The analysis of the structure of Qatar's banking system shows that of the 17 banks that exist at present, Qatar National Bank, one of the six partly government-owned banks, is a clear leader with almost twice or three times the size of its closest rival in all measures. However, Islamic banks have been the fastest growing besides being the most capitalised *vis-à-vis* loans and advances. This shows that the Islamic banks have a huge potential for growth in the market. They have been steadily eating away at the market share from foreign banks which have been waiting for some impetus in the form of faster and better implementation of banking reforms (Al-Muharrami and Mathews: 2009). However, taking the present conditions into consideration, it appears that the Islamic banks will prove to be the winners in future, to the extent that there could be a change in the structure of the banking system in Qatar as it could become more dominated by Islamic banking practices.

3.2.3 Challenges Faced by the Banking System in Qatar

The global economic crisis which has affected all developed and developing economics has also had its adverse impact on the Qatari economy. The construction boom that lasted through the last decade came to a sudden halt in all Middle Eastern economies including Qatar. This exerted severe negative pressure on the banks in Qatar, particularly the partly government-owned top six banks in the country. As they prepared to write-off massive losses due to increasing defaults, particularly in construction and real estate related advances as well as investment losses on the portfolios of securities held by them due to the tumbling of Qatar's stock market, the Qatari government announced an unprecedented move to recapitalise public sector banks by 10-20 percent. Below are the measures taken by the government and the Central Bank of Qatar to save the vulnerable banking sector (QNB Capital, 2009):

- In October 2008, Qatar Investment Authority (QIA), the sovereign wealth fund of Qatar, announced that it would raise the capital base of Qatari banks by 10-20 percent. The fund committed about US D5.3billion for this purpose. The first phase of infusion had already taken place, with the second phase scheduled to happen by the beginning of 2009.

- In March 2009, in order to protect the banks from their investment losses, the Qatari government, through the Central Bank of Qatar, announced that it was willing to buy from banks, their entire portfolio of investments classified as ‘available for sale’.
- In June 2009, the Qatari government stated that it was willing to purchase from banks, real estate exposure worth USD 4.1billion.

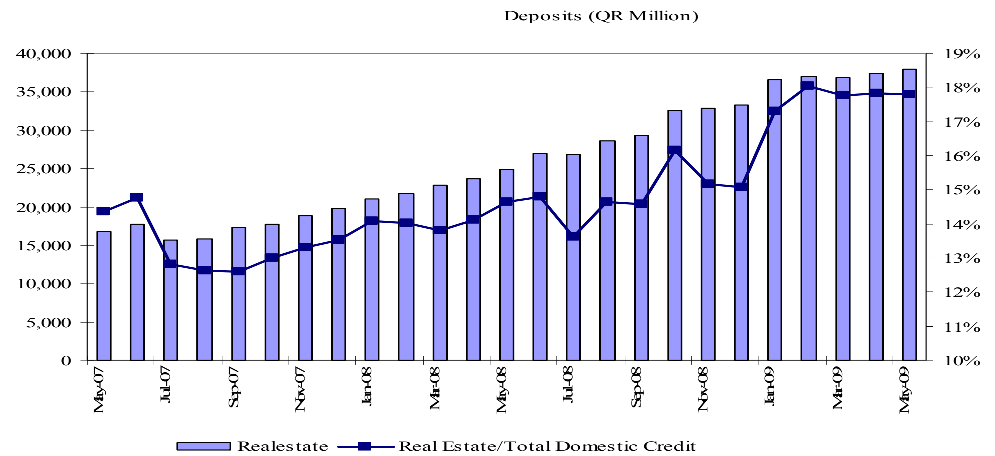
The government bought the investment of portfolios of Qatar National Bank (QNB), Doha Bank, Qatar Islamic Bank, Qatar International Islamic Bank, Ahli Bank and Al Khalij Commercial Bank and Commercial Bank of Qatar. The selling price was set according to the book value of the investment portfolios stated by their original owners for sale at the prices of 28 Feb 2009. In accordance with the terms of the agreement the government paid the full value of the deals with Islamic banks while with conventional banks the deal was funded part in cash and the rest in the form of treasury bonds. The five year bonds will yield fixed returns at 5.5 percent. The agreement also provided Qatar Commercial Bank with the option to repurchase the entire portfolio, or any part of it, after a 12-month period from the date of sale and within a maximum period of five years at the original sale price (Salem: 2009).

These measures have had a positive impact on the country and its banks. As indicated by Haissam Arabi, Chief Executive of Gulfmena Alternative Investments, “By taking away the investment portfolios of the banks, the banks do not have to provide for any losses and can take it away from their books. It boosts their solvency and supports them.” (The New York Times: 2009). All major banks of Qatar, however, have been downgraded by the international rating agencies**.** In February 2009, Moody’s downgraded the entire Qatari banking industry to Negative Outlook. The Qatari government was doing what other governments around the world have been doing in order to prop up their ailing banks. The difference is that Qatar is wealthy enough to undertake such a bail-out without causing a big dent in state finances.

It is important to shed some light on the factors that led to the crisis situation in Qatar's top banks only being averted by the government's intervention. As mentioned before, Qatar's economy has been heavily dependent on the oil and gas sectors and public sector expenditure has been a major contributor to the gross domestic product for many years. The government, as part of its strategic development initiatives, has been encouraging the growth of non oil and gas industries in the economy. This is also in line with similar efforts undertaken by neighbouring economies such as the UAE and Bahrain. The government has also been encouraging credit to the private sector in order to increase its participation in economic growth and development. These factors had led to policy impetus by the banks to provide better credit facilities to private non-oil and gas sectors. Subsequently, since 2000 Qatari banks have embarked on a massive expansion of credit to the private sector.

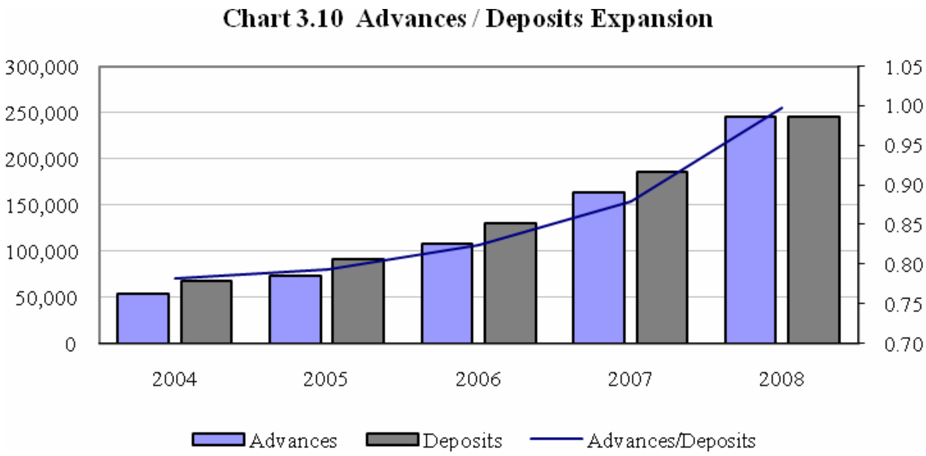
One sector that has shown a rapid increase is real estate. The banks increased their credit exposure to this sector, as can be observed from the graph shown below. Chart 3.9 shows the aggregate value of credit provided to the real estate sector as a percentage of total domestic credit.

Chart 3.9 Aggregate value of Credit Provided



Source: Qatar Central Bank, 2009b

As can be seen, the real estate exposure as a percentage of total domestic credit which was at just 12.82 percent in July 2007, reached a high of 18.04 percent in February 2009. As real estate prices tumbled in response to the worldwide decline in prices, the banks found themselves at the juncture of massive write-downs. Another major problem that contributed to this issue was the failure of deposits to keep up with the expansion of credit as demonstrated in Chart 3.10 below.



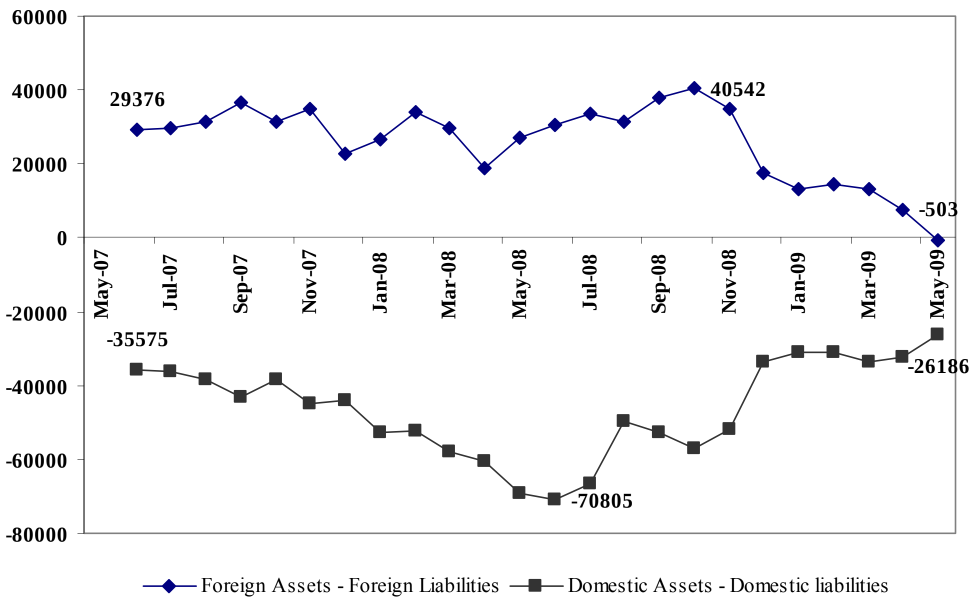
Source: Qatar Central Bank, 2009b

The Advances/Deposits ratio of the banking industry as a whole increased from 0.78 in 2004 to 1.00 in 2008. As the advances grew by 362 percent between 2004 and 2008, deposits lagged behind severely with a cumulative growth of 262 percent during this period. The lack of equivalent growth in deposits forced the banks to lend out of their capital. The decline in deposit rate can be easily explained through a glance at the inflation that prevailed in the economy during this period. In 2008 the average interest rate on a one year deposit with commercial banks in Qatar was 2.97 percent. The Central Bank of Qatar had responded to every cut in interest rate by the Federal Reserve in order to keep the currency peg safe. However this had imported inflation and CPI growth was at 15 percent in 2008. This made the real interest rates double-digit-negative. Therefore the investors in Qatar had no incentive to save their money with banks. Rather they were better off exposing themselves to as many loans from banks as possible.

In the wake of recapitalisation of top banks by the government the banks appear to have escaped the crisis situation that they were facing in the middle of 2008. It is noted, however, that the deposits continue to dwindle and this could be a serious problem for Qatari banks in future as the advance/deposits ratio has already hit the critical mark of 1. The commercial banks have a powerful way of creating money through a circular system of lending and borrowing. The money received as a deposit from a customer, after accounting for the statutory reserves set by the Central Bank, is lent to the monetary system which receives this money and lends once again after removing the reserve portion (Arnold, 2008). Thus money is created during the process which is known as money multiplier effect. In the case of Qatar banks, there are leakages in the form of foreign lending. It is seen that Qatari banks have an affinity to lend foreign credit for which the domestic deposits are made use of. Once the money is lent out of the country, it does not take part in the multiplier mechanism and thus hampers the circulation of credit.

The following chart (Chart 3.11) shows the changes in net foreign assets and net domestic assets of all Qatar's commercial banks combined. It shows that the foreign assets of banks have always exceeded foreign liabilities by a significant margin. In May 2007, foreign assets were 93 percent more than foreign liabilities. On the other hand, it also shows that domestic liabilities have always exceeded domestic assets. This has got to be the case with banks in all countries because of the reserve requirements. However, in the case of Qatari banks domestic liabilities were significantly more than domestic assets. Until September 2008, this condition prevailed. Between May 2007 and September 2008, banks' foreign assets grew 81 percent while domestic assets increased by 77 percent.

Chart 3.11 Changes in Net Foreign Assets and Net Domestic Assets



Source: Qatar Central Bank, 2009b

This diversion of domestic deposits for foreign lending created a continuous leak in money circulation in the country. There could be many reasons for this phenomenon. One of the observations that could be made is that the banks look for foreign investments not by choice but by compulsion. Qatar, with a population of just over 1.6 million, is one of the most over-banked countries in the Gulf Cooperation Council. HSBC in a report states that “Qatar is relatively over-banked with regard to the country’s population size” (HSBC, 2007). On one hand the rate of growth of domestic deposits were falling and on the other hand the domestic banks were finding it difficult to use all the domestic deposits for domestic credit. However this situation has changed since the country got into the global economic crisis. Since October 2008, net foreign assets have declined from QAR 40,542 million to QAR 503 million. In other words, the banks have reached a stage where foreign assets almost match foreign liabilities. This could be due to the credit crisis in the developed economies as well as the lack of growth opportunities in foreign countries owing to economic contraction. On the other hand, the domestic banks have now begun to utilise domestic deposits for deposits credit as is evident from the closing in the gap between these two in the graph given above. As of May 2009, domestic liabilities exceeded domestic assets by just ten percent. This reversal, more due to compulsion than choice, if it persists in future, even after a recovery of world economies, would help to improve the multiplier effect in domestic economy and result in higher growth rates.

The analysis of the structure of banks shows that the national banks, particularly the top three, dominate the industry with over 70 percent of the market share. However, Islamic banks are seen as the rising star, with rapid growth in all measures of performance, while foreign banks lag behind. An analysis of the recent recapitalisation of national banks by the government besides other measures shows that the banks were affected negatively by the developments in the real estate sector, due to their overexposure to the sector. Besides, the decline in the growth rate of deposits was a contributing factor and still continues to be a cause for concern.

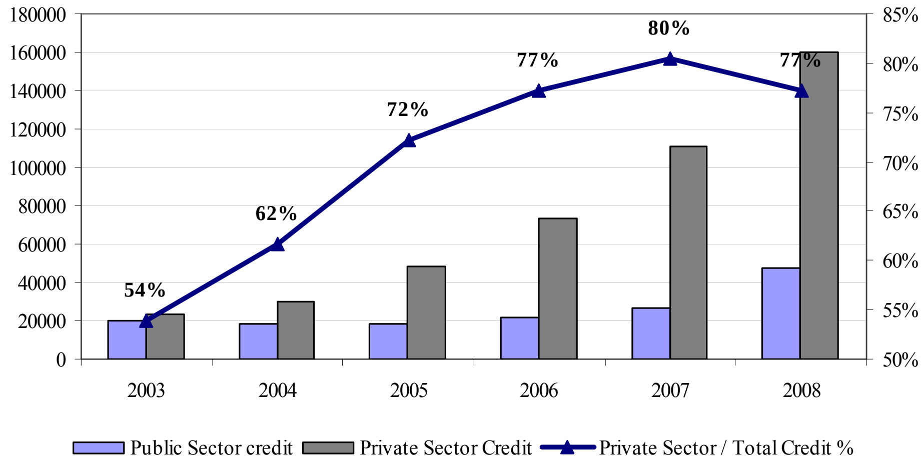
3.4 Impact of the Banking Sector on the Economy

Banks play the all-important role of credit facilitators in any economy. For a rich country like Qatar where most projects are funded by oil and gas wealth, this might not appear as significant as in other countries where bank deposits are an essential part of the cycle of investment and growth. However, due to Qatar’s need to diversify and expand the private sector, rather than a need for capital, this role of banks as facilitators of credit is highly important. This section analyses the role played by bank credit in the economic diversification of Qatar.

Banks in Qatar were traditionally providers of capital and facilities to public sector companies which were majority-owned by the government. As the top bank, QNB was also partially owned by the government, the credit risk or risk of default on the facilities provided to these companies was minimal. However, as the economy opened up and the government encouraged lending to the private sector, the banks faced a steep learning curve as they had to adhere to the prudential universally-followed credit norms while engaging in an act of provision of credit. So far, the banks in Qatar have been quite successful in adapting themselves to this new role and have expanded credit to the private sector to a great extent.

It can be observed from the chart below (Chart 3.12) that total credit expanded about 393 percent between 2003 and 2008. While credit to the public sector increased by 138 percent during this period, credit to the private sector saw a greater growth rate of 662 percent. This six-fold increase in credit to the private sector within a five year period saw the percentage share of private sector credit in total credit increase from 54 percent to 77 percent. This massive expansion in credit to the private sector has been one of the most important roles that the banks in Qatar have played in recent times.

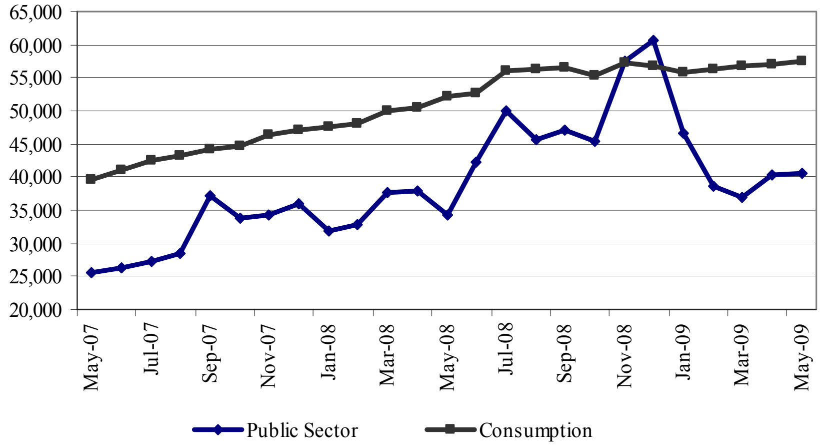
Chart 3.12 Expansion of Credit between 2003 and 2008



Source: Qatar Central Bank, 2009b

Besides government spending, consumption expenditure has been an important contributor to economic growth in Qatar (Tsen, 2007). The banks have helped economic growth through the provision of credit for the purpose of consumption. Credit for consumption has been the single largest component of total credit for Qatari banks. Loans provided for consumption purposes have been even greater than credit made available to the public sector as a whole. The following chart (Chart 3.13) shows public sector credit and consumption credit combined.

Chart 3.13 Public Sector Credit and Consumption Credit



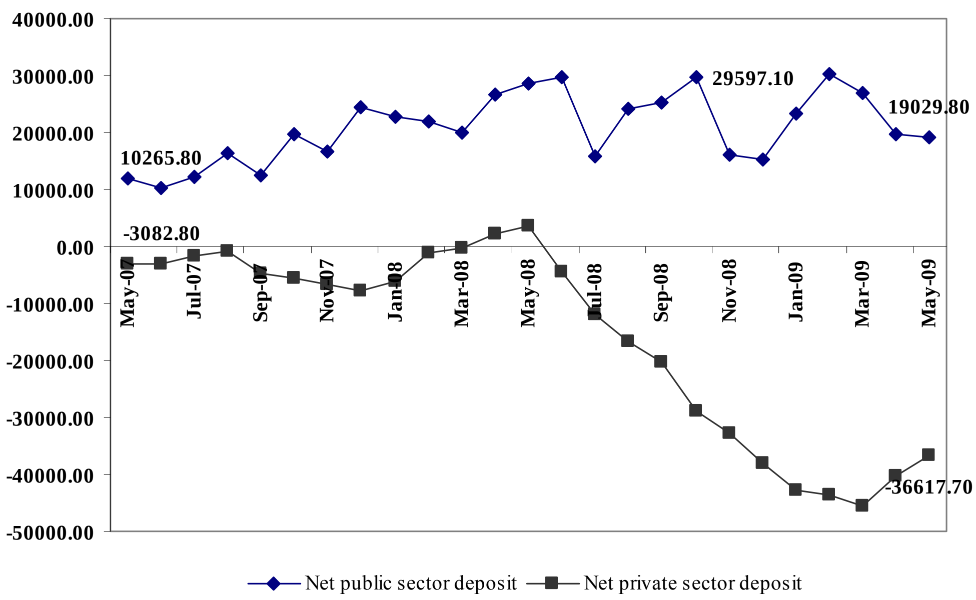
Source: Qatar Central Bank, 2009b

This chart shows that credit for consumption purposes has steadily increased through the period. This has contributed directly to an increase in gross domestic product as consumption expenditure is a main component in the calculation of GDP by expenditure method (Frank *et al*., 2007).

The Qatari Central Bank and the Qatari government have used the commercial banks as agents of monetary stimulus during the period of economic crisis that the economy has undergone. This is evident from Chart 3.14, below. By mid-2008, the decline in the real estate sector and Qatar's external sector economy was evident and it was predicted that the economic growth of the country would be severely hit due to the global economic crisis and decline in oil and gas prices. The Qatari Central Bank then embarked on a massive monetary expansion. On one hand the interest rates were reduced to mirror the federal rates prevailing in the US. On the other hand, banks were encouraged to expand credit facilities to the private sector. The domestic banks were used as the catalysts to growth as the foreign banks, as a part of their global strategy and wide-spread capital erosion, curtailed their lending between June 2008 and May 2009.

It can be observed from the charts given below that a massive monetary push was provided to the domestic private sector credit. The public sector deposits and credit declined by 17.4 percent and 4.2 percent respectively, while private sector deposits increased marginally by 0.4 percent and private sector credit expanded by 23.4 percent. Even though private sector deposit stagnated near QAR 135,150 million, private sector credit expanded from QAR 146.516 million to QAR 172,363 million. On a net basis, this amounts to a huge 702 percent increase during this period. This expansionary lending was supported by Qatar Central Bank as well as the re-capitalisation of major banks. The effectiveness of this activity of the Central Bank could take a while to realise due to the lag effect.

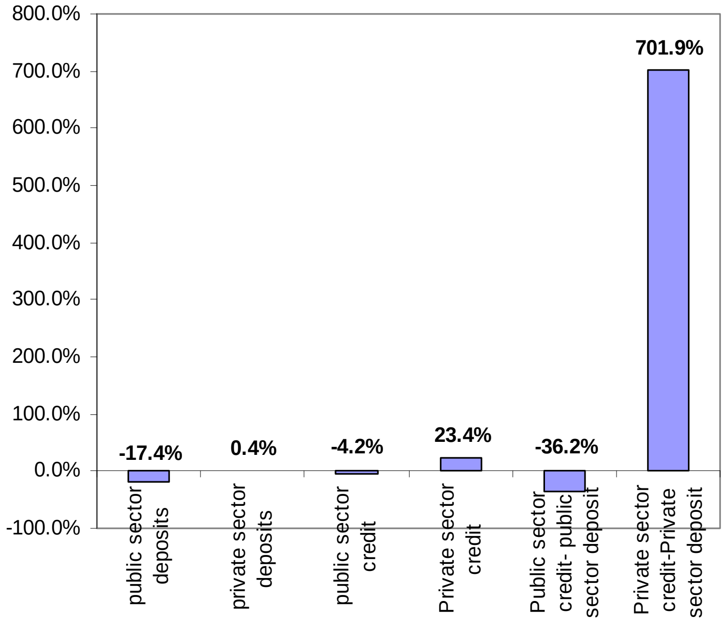
Chart 3.14 Net Public Sector Deposit 'v' Net Private Sector Deposit



Source: Qatar Central Bank, 2009b

A comparison to a similar approach adopted by the US Federal Reserve may be appropriate here. Kahn (1991) states "Fed does not control the availability of bank loans. Unexpected changes in the desired mix of loans and securities in banks' portfolios may partly or completely offset Federal Reserve actions to restrain or stimulate the economy". In a recent interview Dudley, the President and CEO of Federal Reserve Bank of New York, stated that "The facilities cannot address the fundamental problem — the shortage of capital in the banking system.

Chart 3.15 Credit Changes between June 2008 and May 2009



Source: Qatar Central Bank, 2009b

The facilities can slow down the deleveraging process, but until the banking system is viewed as being sufficiently well-capitalized and is able to expand its lending activity significantly, the limits on credit availability caused by an impaired banking system will make it more difficult to generate a sustainable economic recovery" (Dudley, 2009). While the Central Bank of Qatar, akin to its GCC counterparts, is not as vocal as the Federal Reserve is, it can be stated with reasonable certainty that it has better control over the lending habits of the domestic banks than the Federal Reserve has over the lending habits of US banks.

The credit facilities provided by banks has contributed to the economic development of Qatar in two main ways: one, by aiding the emergence of private non-oil and gas sector which has diversified the economy, otherwise dependent heavily on public sector and two, by directly increasing the consumption expenditure of Qatar's population through the provision of credit facilities intended for consumption purposes. Together these two important factors have contributed significantly to the development and growth of Qatar's economy.

However, the current predicament of banks has exposed the difficulty in developing many profitable investment opportunities outside the limited scope of real estate, trade and stock market. This lack of business diversity coupled with excess liquidity have generated the real estate and stock market bubble, both of which turned into bust due to the stresses generated by the eruption of the global crisis. This means that in order for Qatar to be able to go forward with its strategy of diversification it needs to look at ways to strengthen the local banking system by focusing on GCC integration and cooperation, besides its current focus on opening up its economy, through QFC, to foreign capital as a means of diversifying revenues.

3.5 The Evolution and Role of Money Exchange Companies

Until the mid-‘fifties foreign currency and precious metals were purchased and sold by general merchants as part of their trading activities. Also mobile vendors who moved around the country used to carry out these transactions. As a consequence of the changes and development of the Qatari economy manifested by the increased importance of the oil economy and trading activities, the first specialised money exchange company was set up in 1955 with a capital of one million Indian rupees (the Indian rupee was in circulation then) followed by another company in 1969 with a capital of 130,000 Qatar-Dubai riyals.

The money exchange business saw its biggest growth after the 1973 oil price hike and the resultant growth of the economy and the trade sector. As Table 3.8 shows, twelve of the sixteen money exchange companies were established after 1973. Al Fardan Exchange and Finance Company and the Habib Qatar International Finance and Investment Company stand out among money exchangers as most influential; moreover, Habib International has a branch in Zurich. In spite of the growth of retail banking, money exchangers were able to maintain their position in the economy and most currency dealings are conducted by them. This is largely due to the services they provide to the sizeable expatriate community

Table 3. 8 List of Money Exchange Companies Operating in Qatar

Company	Company
Money and Exchange	Middle East Exchange
Qatar Emirates Exchange	Qatar International Exchange
AL Fardan Exchange & Finance	Islamic Exchange
Doha Exchange	Eastern Exchange & Finance
Trust Exchange	Al-Sadd Exchange
Gulf Finance & Exchange	Al-Jazeera Exchange
Habib Qatar international Finance & international	Al-Dar Exchange
Al Zaman Exchange	Arabian Exchange
Global Exchange	National Exchange
City Exchange	Lari Exchange
Al Mana Exchange	

Source: Qatar Central Bank, 2009

Money exchange companies were operating until 1982 without being subject to regulation. In order to regulate and control the business the Qatari government issued Law No.4 of 1982. This law defines the business as a trading activity in foreign currencies, traveller's cheques, and precious metals, and issuance and acceptance of personal drafts in favour of correspondents abroad. The law also indicates that formal permission to set up a money exchange company must be obtained from the Ministry of Finance with due recommendation by the Qatar Monetary Authority, QMA, (at present Qatar Central Bank). The business is only open to Qatari nationals with indigenous capital. New branches or mergers or collaboration between companies is granted and supervised by the QMA.

The agency is also required to undertake all that is necessary to implement the law. The law has provisions for the application of sanctions against those who violate the provisions of the law. Since its enactment the law has been amended once in Law No 9 of 1990. The amendment concerned article No 9. This article stipulates that the license granted for a money exchange company is restricted to the owner of the company. If a change of title to the company occurs, the new owner must apply for a new license. This stipulation was amended to allow the owner to have one or more partners provided he obtains approval from the QMA to be endorsed by the Ministry of Finance (Qatar Monetary Agency: 1985, pp 59-62).

Money exchangers are an important segment of the financial system and play an important role in meeting the domestic needs of foreign currency for a variety of invisible economic transactions such as travelling abroad for purposes of tourism, education or health. More importantly they handle the remittance of funds by expatriates to their families and relatives in their home countries. Remittance abroad can take the form of cash, or travellers' cheques as demand on draft drawn on correspondents: foreign banks, exchange houses or their branches abroad. Thus, money exchange companies constitute a major channel for the inflow and outflow of foreign currency. This increased importance led the government to tighten its control on the business in early 1990 and the monetary authority threatened to withdraw licenses if money exchangers did not abide by the law that organizes their operations and prohibits them from serving as depository institutions such as taking deposits or extending credit facilities to the public. The supervision and control of the operations of money exchangers have also increased through the periodical financial statements provided to QCB and on the spot inspections.

The data in Table 3.9 indicates a heavy reliance of money exchange companies up until the year 2000 on external sources such as credit facilities extended by banks and money exchangers, in addition to discounted cheques and drafts of around 69 percent, while only 30 percent of funds come from internal sources, *i.e.*, capital and reserves. After that the data indicates a substantial increase in internal resources reversing the trend whereby these companies became 69 percent reliant on internal sources. The companies witnessed a substantial

Table 3. 9 Consolidated Balance Sheet of Money Exchange Companies 1997-2008 (QAR million)

Description	1997	1998	1999	2000	2002	2003	2004	2005	2006	2007	2008
Cash	40	45.1	37.9	31.5	41.8	43.1	68.1	74.8	116	125.7	125
Balances with Banks	81.4	92.6	88.4	90.6	70.7	77.4	78	278.7	249.3	262.5	266.6
Balances with Money Exchangers	3.2	8.3	5.7	3.5	9.2	9.2	6.2	16	25.7	37.7	100.5
Fixed Assets	7.7	9.7	7.1	6.9	5.9	5.3	19.7	12.3	28.5	37.8	41.4
Other Assets	30.5	26	29.2	25.7	110	225	334	259.2	181.5	172.3	137.5
Total Assets	**163**	**182**	**168**	**158**	**238**	**356**	**506**	**641**	**601**	**636**	**671**
Capital and Reserves	50.8	57.1	58.6	65.3	140	262	404.2	479.8	447	493.7	464.5
Bank Accounts	76.6	91	61.9	52.7	60	55.1	63.7	89.2	55.7	43.9	52.6
Branches and Exchange Accounts	10.8	8.7	7.8	11.5	0	17.6	16.9	46.9	67.5	62.3	79.9
Other Liabilities	24.6	24.9	40	28.7	37.6	21.7	21.2	24.9	30.8	35.6	73.9
Total Liabilities	**163**	**182**	**168**	**158**	**238**	**356**	**506**	**641**	**601**	**636**	**671**

Source: Qatar Central Bank, 2008

increase in total assets as a result of expansion in investment in the domestic financial market. The largest portion of the increase can be attributed to two major factors; the first is the revaluation of the companies' portfolio of domestic share due to the high rise (of about 70 percent) of the Doha Stock Market's general price index throughout 2003 and the second is the augmentation of the companies' investments in financial securities. The table also shows that more than half the money exchange companies' assets are used in the form of credits in banks and money exchangers – primarily abroad - in order to finance payment orders written by the money exchangers to beneficiaries. This is an indication of the significant role the money exchangers play in servicing the expatriate community of Qatar. The rest of the funds were used in a variety of forms such as cash for daily transactions and investments.

3.6 Role of Qatar's Central Bank in Promoting Financial Stability

The development of the Qatari economy has been accompanied by the evolution and strengthening of the role of the Central Bank of Qatar as an essential part of the evolving structure of the financial system. Like many other Gulf States, Qatar did not have its own national currency before 1973. The Indian rupee was the currency until the mid 'fifties when it was replaced by the Gulf rupee until the mid 'sixties. In 1965, a Gulf Currency Agreement was signed by the rulers of Qatar, Dubai, Abu Dhabi and Bahrain in order to unify the currency of the region.

Due to a delay in implementing the agreement, Qatar and Dubai took measures to evolve their own currency and signed the Qatar-Dubai Agreement on 21 March 1966 which was later amended during August of the same year. According to the agreement the currency came to be known as the Qatar-Dubai riyal and a board was set up to take charge of the issuance and redemption of bank notes and coins. The merger of Dubai with the United Arab Emirates and the creation by the new state of a national currency, namely the U.A.E Dirham, on the 19th May 1973 resulted in the dissolution of the Qatar-Dubai Currency Board. The assets and liabilities of the Board were transferred to the Qatari government and subsequently the establishment of Qatar Monetary Agency, QMA, came about (Qatar Monetary Agency, 1985: pp23-28).

The agency was established on the basis of law No 7, 1973 and was granted the powers of a central bank. Its establishment coincided with the huge influx of oil revenues due to the quadrupling of oil prices in 1973. This gave the agency position and prominence and enabled it to make use of the new economic situation effectively, develop methods and procedures to control the banking sector and align its development with the development of the economy. The objectives of the agency as stipulated by law are:

1. To regulate the issuance, redemption and supply of currency;
2. To safeguard the internal and external value of the currency and its convertibility into other currencies;
3. To promote credit and create conditions conducive to the growth of the economy within the framework of monetary stability;
4. To supervise the banks' activities (*ibid*, p25)

This original legal framework of managing the monetary issues of the country and the banking system has been replaced by law No 15, 1993, establishing Qatar Central Bank (QCB). One of the major reasons for this was to help achieve, "a much more effective role of Qatar Central Bank in enhancing the bases of stability of the banking institutions and reinforcing the outstanding achievements that were accomplished by the banking sector" (Qatar Central Bank, 2002: p27) Three main objectives were specified in the new law that showed the need to link monetary issues to economic policies and strengthen the development of the economy. These were:

1. To administer the monetary policies and banking insurance to accomplish the government's economic policies.

2. To organise and supervise banks and financial institutions in accordance with the provisions of the law.

3. To act as the bank of banks operating in the country (*ibid*).

Qatar Central Bank inherited all the responsibilities of the monetary authority with the additional function of overseeing the running of all financial institutions including banks, insurance companies, brokerage houses and money exchange houses and linking its activities to the country's economic policy. The pegging of the Qatari currency to the US dollar limited Qatar's monetary policy; in fact its monetary policy mirrors the monetary policy of the Federal Reserve of the United States. In 1975, QMA pegged the value of the Qatar Riyal to the IMF's Special Drawing Rights with a fluctuation margin of ±2.25 percent. QMA used the United States Dollar (USD) to determine the value of the Qatar Riyal on a daily basis (Qatar National Bank, 2006).

A system was created in such a way that the value of the Qatari Riyal against the USD was determined on the basis of the value of the USD against the SDR. The Qatari Riyal's value against other currencies was determined on the basis of the USD's value against those currencies. The Qatari Riyal underwent a series of revaluations, the cumulative effect of which was an appreciation of 8.5 percent to compensate part of the 13.4 percent depreciation in the USD against the SDR during that period. Since 1980, Qatar has maintained its peg to the USD at QAR 3.64 per USD. As the USD began its appreciation, the QAR has also appreciated against the currencies of almost all Qatar's trade partners. However, because of the currency peg, Qatar has imported significant inflationary pressures from abroad (Setser, 2008). Inflation is expected to level out because of the fall of global commodity prices, the drop in the cost of construction and the introduction of new housing stock into the Qatari market. However, following a further deterioration in the US economy, the dollar could be back on the decline again and imported inflation back on an upward trend. The Qatari government and QCB are limited in their power against such an eventuality as long as the Riyal is pegged to the US dollar (The Report Qatar, 2009: p43).

Despite this linkage to the US dollar, which at times appeared unfavourable to Qatar, the management of the country’s financial system proved over the years to be effective and helped maintain a steady and impressive growth of the economy, encouraging the expansion in private sector interests. It is worth mentioning some of these effective policies. The QMA focused on encouraging the development of national banks at a time when the sector was dominated by foreign banks. Consequently, it restricted the issuance of licenses to national banks only. This policy was essential for the creation of national economic institutions and for providing new opportunities for local businesses.

The QMA also dealt effectively with the difficulties faced by banks as a result of the Iraqi invasion of Kuwait, and took measures that helped maintain confidence in the system during the 1990s. It gave banks the option to accept or reject the withdrawal of deposits before maturity dates as long as they operated within the legal requirement of liquidity status. It also imposed a restriction on all money exchangers to sell the USD at a rate not exceeding QAR 3.68. Those who violated the ceiling were warned about legal penalties. In 2000, QCB faced a serious problem with one of its national banks, Al Ahli Bank of Qatar. The bank was hit by a severe loan problem caused by the defaulting of one of its major customers. The level of exposure of the bank was around 40 percent of the total bank loan portfolio. The QCB rescued the bank by providing a 10-year guarantee with an amount equivalent to the bank’s defaulting loan (USD 28 million). The agency was also able to change the bank’s management and required significant bank restructuring. There is recognition in the Qatari government of the need to improve the performance of top management as indicated by the Governor of Qatar Central Bank, Sheikh Abdullah bin Saud Al-Thani:

> One of the major challenges facing the Qatari banks is the competence of top management level. There is a need to increase its efficiency and effectiveness, especially in light of the fast pace of changes in the banking business. Top management must be ready and capable to absorb these changes and act in the best interest of its clients (Interview, July 2008).

The general trend for tighter control and regulations of the banking sector continued until the mid 1990s by increasing the supervision of all banking activities, including the appointment of banks' top management teams, tighter control on credit facilities and tighter control on money exchange companies. A change of policy took place, during this period, in 1995, when QCB started a series of steps to liberalize the Qatari market by freeing interest rate on credit. As was expected, rates were consequently raised. This was followed by partial freeing of interest rates on deposits of more than 15 months. The freeing of interest rates continued by abolishing restrictions on interest rates on saving accounts of more than 12 months while those less than 12 months were subjected to maximum limits set by the Central Bank. This helped to substantially increase long-term deposits, and hence gave banks access to medium-term finance resources. By 2000, the Central Bank freed interest rates on the Qatari riyal totally, giving banks the freedom to determine interest rates on deposits of various terms in line with market forces. The rate of reserves of all current accounts was also dropped in 2000 from the rate in use since 1995 of 19 percent to only 2.75 percent. This was in line with the government's strategy of opening up the economy and increasing its competitive edge. However, this had the effect of increasing lines of credit substantially and expanded the activities of the real estate sector significantly resulting in heightened speculative activities. This, coupled with speculative activities in the stock market, caused the current excessive exposure in these vulnerable sectors.

From late 2007, QCB has been addressing some of the key issues underpinning the downturn in the banking system, such as reducing interest rates, increasing the mandatory reserve ratios, issuing certificates of deposit, granting special credit facilities to Qatari banks with suitable interest rates, and canceling the deposit limit at QCB in accordance with the Qatari monetary market interest rate mechanism. QCB has also taken certain precautionary measures to limit exposure of banks to these two sectors, such as restraining credit for real estate financing and shares purchasing, although by IMF standards, credit expansion in Qatar in general, is still viewed as high.

The dilemma facing the QCB was how it could strive to maintain a balance between the country's development needs at this stage, and financial stability. Several instructions have been issued by QCB over the last few years to mitigate credit risks, with particular emphasis on the risks of financing the real estate sector and the purchase of shares. Also, corporate governance regulations were issued by the QCB in February 2008 which incorporated sound banking principles and guidelines. QCB has held many bilateral and multilateral meetings with the managements of banks to discuss the repercussions of the financial crisis. These meetings were very beneficial as they led to the scheme to rescue the banks. The QCB and the government pro active approach have averted a crash in Qatar's financial system.

The downturn of the banking sector has impacted directly on the government plan that was meant to come into effect in 2008 to create a unified regulatory body by merging banking supervision sections of Qatar Central Bank with Qatar Financial Centre Regulatory Authority (QFCRA) and Qatar Financial Markets Authority. Such a step would have meant taking away its regulatory and supervisory functions from the Central Bank. As indicated by Stuart Pearce, "The Central Bank will do what central banks do and that is to be responsible for the exchange rates and monetary policy (Interview, July 2008). This would have reduced the power of the Central Bank significantly. Commenting on the government decision to halt the plan , Phillip Thorpe , CEO of QFCRA, said, "The three regulators are getting on and doing our job separately, we have been in a holding pattern for some time now" (Qatar Today, April 2009:p22).

However, other factors also played a role**.** The current crisis in global financial markets and the experience of separating the function of the central bank and financial regulation in Britain, and its unsuccessful model of a unified regulatory body might have dampened the enthusiasm for such a move. Also, the Governor of QCB is not in favour of such a move. Elaborating his view on a unified regulatory body, he said,

> It is more effective and prudent to maintain the regulatory and supervision function in the hands of the central bank. We do not see the British model of separation of central bank and financial regulation as an effective way of managing the financial system especially in times of crisis. In Britain, the central bank and the regulatory body are blaming each other for the current financial crisis. Such a situation undermines the financial system and investors' confidence, something we should avoid here in Qatar. Our financial system is very young and unseasoned. There is no need to speed up the process of integration and give up the regulatory function to QFC (Interview, July 2008).

It is understandable, when the financial markets are in such turmoil and have been stabilised through massive injection of funds by governments worldwide, that the Qatari government should take a cautious approach towards changing its regulatory structure and opt to maintain the current one. Also the Qatari banking system might still require further support from the government, and need to adjust to the new challenging environment, as indicated by the Governor of QCB:

> Our banks and financial institutions are sound and fundamentally strong with the continuing support from the leadership and the Government of Qatar. We should continually be aware of which will surface in the coming months as a result of the ongoing financial crisis. Therefore, banks should revisit their credit and investment policies in the light of these challenges and carefully balance between their legitimate wishes to realize growth and development, and their abilities to face the potential risks (Interview, July 2008).

The Central Bank, as the discussion showed, has been effective in carrying out its functions. This view is shared by the business community in Qatar. As indicated by Adel Mustafawi, CEO of Al-Rayan bank, "The management of the Central Bank of the financial system is strong and its supervision is sound and its regulations are very clear" (Interview, July 2008). Others express more vocal views about QFC, such as the Managing Director of International Bank of Qatar who indicated that “The presence of the QFC will destroy our financial system; its rules and regulations are not clear and its supervision is lenient” (Interview, July 2008). There is more confidence in the business community in the QCB *vis-à-vis* QFC, and the government has a long way to go in convincing the business community of the benefits associated with QFC and any regulatory body that might be connected with it.

3.7 Conclusion

The development of the banking system in Qatar has played an integral part in the country’s rapid economic growth in various ways. Some relate to building a solid infrastructure including the issuance of a national currency, the establishment of national banking institutions, the creation and development of a modern Central Bank, and the creation of a sound regulatory frame to influence and control the development of the banking system, while others contribute directly to the growth of the economy through providing credit to the private sector in non-oil and gas sectors as well as supporting consumer expenditure and higher standards of living. However, to a great extent this was the result of both government effort and protection of the sector from foreign competition as well as its need to redistribute some of the state’s massive wealth.

The current financial crisis has revealed some weaknesses in the system such as its over-exposure to specific sectors, and the overall unseasoned nature of the nascent banking industry and it’s over-reliance on the government. The banking system has been propped up by government bailout and the strength of the system at the present is closely tied to the sound economic performance of the country and the support offered by the state. The future of banking is still reliant on the state as indicated by Qatar’s Prime Minister, “Qatar has set aside about USD 150 billion for various projects over the next four years and stands ready to inject funds into local businesses”. These teething problems, some of which are structural such as its heavy exposure to particular sectors of the economy, while others are related to the global financial environment, put a question mark over the ability of this sector to contribute to the government's policy of diversification and increasing the role of the private sector. Some of the weakness inherent in the system, due to population and market size can be overcome through greater GCC economic integration.

Chapter Four

The Expansion of Non-Banking Financial Services in Qatar

4.1 Introduction

Although Qatar follows the pattern seen in developing countries of a low profile for non-banking financial activities and the predominance of the banking system in the overall financial sector of the country, this is slowly changing and non-banking financial activities have witnessed some rapid changes. The most significant of these have taken place in recent years and are manifested in the expansion of the equity market, facilitated by the creation of a stock market, while the debt market has seen an expansion in the issuance of corporate bonds, especially in *sukuk*, Islamic bonds, as well as a growth in the insurance business and investment and finance companies. The discussion of insurance businesses and investment and finance companies will be the focus of the following chapter. Suffice it to say here that, for a while, the dominant feature of the non-banking financial system in Qatar was the insurance sector, but with the emergence of a nascent equity and debt market, the sector is diversifying and impacting on the expansion of private sector interests in the Qatari economy.

It is estimated that Gulf Cooperation Council (GCC) citizens own some USD 500 billion in liquid financial assets (cash, stocks, mutual funds, etc.) held outside the GCC financial system (Bakheet: 1999). The GCC governments need to attract part of this private wealth back, in order to help in the process of diversifying the economy and minimizing the impact of the volatile oil price and its damaging aftershocks**.** The private sector can act as a safety net for the impact of oil price changes and the huge dependence of the GDP on that one sector. Furthermore, the recent volatility of the price of oil and the current financial global debacle makes it even more imperative to invest these surpluses in the region and increase the focus on the diversification of the economy. Achieving this is no small feat, considering the limited size of the Qatari economy, but with an outward-looking, open economy, focusing on the opportunities in the GCC region, the Arab region and beyond, an expansion in the role of the private sector is possible. However, because of the massive size of the oil and gas revenues, the economy will tend to be skewed towards a prominent position of public sector investments and activities.

The discussion in this chapter reveals three important points:

Firstly, despite the Qatari government's intervention and support of the development of non-banking activities, more needs to be done in order to spread the benefits of the equity and debt markets to the economy and to integrate these markets with the GCC member states. Most of the GCC countries have limited local markets, with the exception of Saudi Arabia, and any meaningful development and deepening of non-banking activities requires a more coordinated effort to capture their full potential. A standardized and well-regulated unified market can create a very dynamic and influential regional capital and debt markets that can service the region and compete globally. There are immense difficulties in carrying out such a task as has been indicated by several of the interviewees. Saif al Mansoori of the Qatar Exchange points out the differences in the regulations and legislative framework of each of the GCC countries as the most significant obstacles towards such integration (Interview, July 2008). However, when there is a political will and a political decision is taken, such obstacles can be overcome, especially considering the similarities of economic challenges facing the GCC countries.

Secondly, expanding the investor class and building an environment that encourages entrepreneurship in order to build a vibrant private sector will take time and effort. This has been identified by all interviewees as one of the key areas where knowledge and experience of investors, especially small and medium-sized businesses, need to increase - as the boom and bust of the stock market showed. As poignantly pointed out by the Minister of Economy and Finance "Local investors had a painful lesson to learn that the markets aren't a one-way ticket to wealth...No country or region can immunise itself against a recession. We all need to question the easy assumptions we have made about how to do business" (Interview: July 2008).

Thirdly, the global financial crisis should be seen as an opportunity for the GCC to develop its markets and establish a regional financial centre on a par with other financial centres in the world, rather than the present duplication of financial centres which weakens the ability of the region to do so. In order to realize this, a long term strategy of linkage between human capital development and economic strategies is paramount in order to reduce dependency on foreign labour and create job opportunities for GCC nationals. Although Qatar has expanded its education and has allocated a huge amount of resources to this sector, there is the challenge, as pointed out by Stuart Pearce, of not only creating educated and well-trained people, but people who are innovative in their thought processes and who can contribute to the economy (Interview: July 2008). Moreover, this is a great opportunity to focus the minds of the political leadership in the GCC to actualise the integration of their economies for the benefit of their long-term stability and viability.

The following analysis will concentrate, firstly, on discussing the Qatar Exchange and analysing its role in the economy. This will be followed by an investigation into the need to integrate the stock markets of the Gulf region. Thirdly, the chapter will discuss the Qatari debt market by looking at the bond market, especially Islamic bonds, followed by an evaluation of the need to integrate the bond market in the GCC. Lastly, it will assess the recent changes in the private equity market and its impact on the expansion of private sector activities.

4.2 Emergence and Growth of Qatar Exchange

The decision to encourage the development of Qatar's equity market by establishing the Doha Securities Market (DSM) in mid 1995 is part and parcel of the government's strategy of strengthening the private sector and expanding domestic investment opportunities. One has to bear in mind that most of the GCC stock markets are a recent feature of their financial systems. The oldest market in the Arab Gulf is in Kuwait. It started naturally, with private investors buying and selling on the kerb, and it was only regulated and developed into an official exchange in 1977, while Saudi Arabia, the largest market, does not have an official exchange but the Saudi Monetary Agency, the *de facto* central bank, sponsors a sophisticated computer-based stock trading system, the Electronic Securities Information System (ESIS).

The operations of the Qatar Exchange started in 1997, with the trading of eighteen participant companies. Trading in that year was limited to a number of transactions and value of shares; it stood at 1317 transactions with a value of QAR 196 million. (Qatar Central Bank Annual Report: 2005). From then onward the market witnessed a steady rise in its activities. The substantial growth of the market coincided with the hike in oil prices when oil income was beginning to boost investors' portfolios. The resulting market was fast, lucrative and profitable for many individuals; however, this boom was followed by a bust and a correction of prices in 2006 with big losses to many people.

In a bid to revitalise and enhance the profile of the market, the Qatari government changed the name of the Doha Securities Market to the Qatar Exchange. It also agreed the sale of a 20 percent stake for USD 200m to NYSE Euronext, operator of the New York Stock Exchange and Paris Bourse and other European centres, to facilitate the use of the latter's trading technology to launch new products largely unavailable on its regional rivals' markets. A spokesman for Qatar Holding, owner of the remaining 80 percent stake in the Qatar Exchange and part of the Qatar Investment Authority (QIA), noted that the purpose is to "Take the Qatar equity market to a new level. This project is going to reinforce our presence on the world map. It is a huge coup for the country, and reinforces our plans to expand globally" (Independent: 2009). This Partnership with NYSE will undoubtedly help develop the Qatar market into a multi-asset class exchange, which will include shares, ETFs (exchange-traded funds), ETCs (exchange-traded commodities), bonds, *sukuks* and index products**.**

The Qatar Exchange will install NYSE's Universal Trading Platform, which is being rolled out across NYSE cash and derivatives markets globally, to launch Qatar's own derivatives exchange. The initial types of product will be based on market demand, but will probably include single stock options and future and index options. The Bourse's focus on new products reflects the tough task it faces in securing regional rivals in terms of equity trading. Daily trading on Qatar's index averaged just 18 million shares during 2008, while volumes on the Dubai and Kuwait benchmarks were 598 million and 760 million respectively. The Qatar Exchange is planning an initial public offering. The likely timescale, the size of the stake to be sold or how much the company would look to raise has not yet been decided.

The following is a detailed analysis of the main characteristics of the securities market and its impact on the economy prior to this new development. It might also shed light on why such a bold step was needed to bolster the equity market, especially if the government is looking to compete on a par with Dubai and Abu Dhabi and to compete globally. As Qatar’s Prime Minister, Hamad bin Jassem bin Jabr Al-Thani indicated, the opening of the Qatar Exchange “Paves the way for Qatar to take a prominent role in the world’s capital markets for the benefit of both the people of Qatar and the Middle East more generally” (*Ibid.*)

4.2.1 Market Size

Qatar’s stock market is very small both in comparison with other emerging markets and in absolute terms. However, that is a characteristic of all GCC stock markets with the exception of Saudi Arabia and even Saudi Arabia’s market, if compared to some emerging markets, is considered relatively small. As seen from Table 4.1 Doha is placed third in the region in terms of capitalisation and fifth in terms of value of traded stock. This is understandable considering the small size of the overall market in Qatar.

Table 4.1 Market Size of GCC Stock Markets - Dec 2008

Market	Value Traded (Million USD)	Shares Traded (Million)	Market Capitalization (Million USD)	No of Contracts	Turnover (%)
Abu Dhabi Securities Market	61,279	48,347	61,887	1,090,143	99.0%
Bahrain Stock Exchange	1,905	1,480	19,954	40,387	9.5%
Doha Securities Market	41,250	3,400	76,657	1,865,516	53.8%
Dubai Financial Market	69,880	66,066	65,218	1,849,953	107.1%
Kuwait Stock Market	116,023	75,820	113,527	1,874,201	102.2%
Muscat Securities Market	8,034	3,881	15,643	815,620	51.4%
Saudi Stock Market	483,122	54,442	246,809	1,082,545	195.7%

Source: Arab Monetary Fund, available at http://ww.amf.org.ae/venglish/default.asp

Nonetheless, the market has been an important vehicle in attracting the investment of private sector wealth in the domestic economy and in supporting the government's policy of diversification of the economy. Obviously the size of the market and its development is highly dependent on the introduction of new listings, the number of which more than doubled following the establishment of DSM, increasing to 43 companies trading in the four main sectors of the economy as follows: banking (nine companies), insurance (five companies), industry (nine companies) and services (22 companies). This relatively small number of listed companies is common to all other Gulf stock markets. For instance Saudi Arabia, the largest in the region, has only 135 listed companies. Most family businesses are not listed on the stock market and there is a need to restructure these and transform them into public listed companies, and by doing so their longevity and the expansion of the size of the stock market will be ensured. This particular issue will be discussed further in section 4.3. However, in terms of growth, the market has grown significantly over a short period of time. The 17 companies the exchange began with grew to 43 listed companies and the total market capitalisation grew from a mere QAR six billion to QAR 279 billion by the end of 2008. It dropped from its 2007 peak of total market capitalisation of around QAR 348 billion. Not only is the size of the market small, but capital is concentrated in the hands of a few companies in each sector, as seen from the data in Table 4.2. For instance, the banking sector is dominated by the Masraf Al-Rayan and Al-Khaliji Bank, while insurance is dominated by the Qatar Insurance Company.

Qatar Industries dominates the industrial sector, while Ezdan Real-Estate, Aamal Investment Company and Qatar Gas Transportation dominate the service sector. This reflects the concentration of economic power in the hands of the few and the need to transform family businesses into corporate enterprises. Despite these limitations, the presence of a stock market is a much-needed development to increase the interest of local capital in local and regional businesses and part of the process of increasing the significance and contribution of the financial system of Qatar in its economy.

4.2.2 Market Trading

The value of shares traded during the decade-long operation of the stock market has seen substantial increase from a the low level in 1998 of QAR 970 million to QAR 109 billion in 2007, representing a 100 percent annual growth rate which was experienced across the different sectors (see Table 4.3). Trading in the shares of the banking sector accounted for 40 percent of trade for 2007, followed by services with 35 percent, industry with 21 percent while insurance accounted for only four percent. This is an improvement in the distribution of the relative shares of the different sectors from its level at the start of trading in 1998 where the financial sector had the lion's share of 66 percent, services 23 percent, industry only five percent and insurance six percent. However, these improvements in the performance of the services and industry sectors are due to the significant contribution of one company in each sector; Qatar Telecommunication (QTEL) and Qatar Industries. So the heavy market concentration remains a major characteristic which needs to be addressed.

Despite this significant expansion in trade within a relatively short period of time, the market remains shallow; the turnover rate was around 54 percent for 2008, a much lower rate than those of Saudi Arabia (196 percent) Dubai (107 percent) and Kuwait (102 percent) as seen in Table 4.1. One of the reasons for that is that the government still holds a large share of listed firms that rarely trade and

Table 4.2 Capital of Companies Listed on the Qatar Exchange (QAR ‘00(

Sector	Organisation	2007	2008	2009
Banking	Ahli Bank of Qatar	507,812	583,984	613,184
	Commercial Bank Of Qatar	1,401,579	2,062,053	2,165,156
	Doha Bank	1,248,175	1,722,481	1,808,606
	Qatar National Bank	1,824,974	2,408,966	3,011,207
	Qatar Islamic Bank	1,193,400	1,969,110	2,067,566
	Qatar International Islamic Bank	700,781	1,261,406	1,324,476
	Masraf Al Rayan	7,500,000	7,500,000	7,500,000
	First Finance	352,634	511,319	639,149
	Al Khalij Commercial Bank	7,200,000	7,200,000	3,600,000
Insurance	Qatar Islamic Insurance Co.	150,000	150,000	150,000
	Qatar General Insurance & Reinsurance Co.	136,400	204,600	255,750
	Qatar Insurance Co.	424,710	424,710	743,243
	Al Khaleej Insurance and Reinsurance Co.	101,640	142,296	142,296
	Doha Insurance Co.	127,240	180,000	180,000
Industrial	Qatar Industrial Manufacturing Co.	300,000	300,000	300,000
	Qatar National Cement Co.	357,095	357,095	446,396
	Zad Holding Co.(Qatar Flour Mills Co.)	72,600	76,230	91,476
	United Development Co.	1,072,500	1,072,500	1,072,500
	Qatar German Co. for Medical Devices	57,750	115,500	115,500
	Industries Qatar (IQ)	5,000,000	5,500,000	5,500,000
	Gulf Holding Co.(Gulf Cement Co.)	800,000	800,000	1,243,267
Services	Qatar Telecom (Q-Tel)	1,000,000	1,466,667	1,466,667
	Qatar Cinema & Film Distribution Co.	21,449	23,594	25,954
	Qatar Electricity & Water Co.	1,000,000	1,000,000	1,000,000
	Qatar Fuel Co.	300,000	300,000	315,000
	Qatar Gas Transportation Co.	5,600,000	5,600,000	5,600,000
	Medicare Group (Ahli Hospital Co.)	281,441	281,441	281,441
	National Leasing Co.	299,880	299,880	329,868
	Qatar Navigation Co.	468,000	600,210	600,210
	Qatar Real Estate Investment Co.	720,000	864,000	864,000
	Qatar Shipping Co.	1,000,000	1,100,000	1,100,000
	Qatar Technical Inspection Co.	40,000	40,000	40,000
	Salam International	828,015	931,516	989,737
	Qatar Meat & Livestock Co.	300,000	300,000	180,000
	Gulf Warehousing Co.	250,000	250,000	250,000
	Dlala holding	200,000	200,000	200,000
	Barwa Real Estate Company	2,000,000	2,625,000	2,625,000
	Mannai Corporation	120,000	144,000	158,400
	Aamal	3,450,000	3,795,000	3,795,000
	Qatar & Oman Investment Co.	300,000	300,000	300,000
	Ezdan Real Estate Company		4,569,000	4,569,000
	Islamic Financial Securities Company		40,000	40,000
	Gulf International Services		1,228,699	1,351,569

Source: Qatar Exchange, 2009

Table 4.3 Trading on the Qatar Exchange 1998-2008

(Value in QAR millions; Quantity in 1000 Shares)

Items	1998	1999	2000	2001	2002	2003	2004	2005
Banking sector								
Value of Shares	637	608	299	609	1,467	3,418	9,258	28,451
Quantity of Shares	13,843	13,103	7,561	16,106	30,119	38,983	54,884	94,687
Number of Deals	3,515	5,899	4,646	5,283	8,127	15,050	49,195	134,904
Insurance Sector								
Value of Shares	62	58	35	65	165	344	921	2,516
Quantity of Shares	839	829	870	1,380	3,968	6,684	8,339	11,695
Number of Deals	364	485	517	564	1,766	3,318	6,363	17,629
Services Sector								
Value of Shares	220	458	4,741	767	1,348	3,968	8,028	44,552
Quantity of Shares	13,779	4,735	20,850	30,649	38,313	72,373	143,485	696,435
Number of Deals	2,942	5,688	5,814	8,473	16,057	56,424	152,713	760,721
Industry Sector								
Value of Shares	51	114	61	63	235	3,992	4,888	27,323
Quantity of Shares	2,767	16,,606	2,328	2,880	7,207	71,933	98,567	230,264
Number of Deals	926	1,892	1,248	1,451	3,837	59,904	76,373	216,793
Total								
Value of Shares	970	1,238	5,136	1,504	3,215	11,722	23,095	102,843
Quantity of Shares	3,123	28,167	31,609	51,015	79,597	189,973	305,387	1,033,081,166
Number of Deals	7,748	13,964	12,225	15,771	29,787	134,696	284,644	1,130,047

Source: Qatar Exchange, 2009

strategic shareholders, either major local families or foreign joint ventures, which limit the shares available for trading. One way of overcoming this is for the government to liquidate its holdings in order to encourage private investors. However, considering the current financial climate, this is unlikely to happen in the foreseeable future since the government's focus is on maintaining the stability of the system and preventing the collapse of these listed companies.

The current relative stability of the market is due largely to the government's emergency plan that bought the investment portfolios listed on the Qatar exchange of local banks as discussed in Chapter Three. This measure, as well as boosting the banks' solvency and stimulating liquidity in the market, removed the volatility in share trading and the main trading index advanced nine percent while the Qatar National, Qatar Islamic and Qatar Commercial banks all rose ten percent (The New York times: 2009). The Qatari government had the means and the political power to act in order to limit the impact of the global financial crisis because of its massive savings from the sale of its oil and gas. It was able to buy bank portfolios in order to provide liquidity to facilitate lending and to support the equity market. The main priority for the government is to sustain the confidence of investors after the severe fluctuation in the price of shares during 2002-2005, and the continued fluctuations that the market has been facing since.

The Qatari stock market went through two phases; the first during the period 2002-2004 where an increase in share prices occurred as a result of strong economic fundamentals, the growth of the GDP and price of oil. However, in the second phase during the tremendous boost of prices in 2005 of all listed companies, some nearly doubling in value, especially in the banking sector, was not reflective of the economic fundamentals. Other factors, such as the process of privatization, played a detrimental role. The use of IPOs as the preferred method of privatization with the policy of pricing these offerings below their market value as a means of redistributing wealth among the population has an impact on prices. This factor alone, according to some sources, could explain two-thirds of the Qatari stock price index gains alone during 2003-5, while strong speculative demand explains the severity of the correction of the price (Mansur & Delgado: 2009, p 8). The speculative demand has risen due to structural weakness in the GCC equity market; there is a limited supply of stocks, sector concentration and lack of alternative domestic financial assets; the demand for small investors; lack of strong institutional investors (the market share of institutional investors in Qatar is two to three percent while the highest is only ten percent in Abu Dhabi, well below the average of emerging markets) and undeveloped cross holdings of listed companies (*ibid*, p19-20). Also the move away from investing in foreign assets by domestic investors increased demand on investments in the region. These have pushed up both real-estate and the stock market due to lack of other assets in which to invest.

Subsequently, the bubble burst and a major correction took place in 2006 that wiped out all the gains accumulated in the previous three-year hike and, in 2007, prices settled at a level that was, for many companies, much lower than they were in 2004, as seen in Table 4.4. The worst-affected companies were in the banking sector, where almost all experienced a very sharp decline in the share price from the high of 2005. It was the same in the insurance sector, with Qatar Islamic Insurance being hit the hardest. The decline in service sector companies' share price was the least severe, with Qatar National Navigation and Transportation as well as Qatar Telecom being hit the hardest.

Boom and bust cycles happened before in the GCC. The first was in Kuwait with the 1982 bust of Souk Al-Mannak due to the lack of effective regulation for over the counter trade. The 1991 Saudi Arabia bubble was a result of the repatriation of funds after the invasion of Kuwait and the 1998 Omani bubble came after the market was opened to foreign investors. Little has been learned from these previous boom and bust cycles, especially that it is possible to prevent a bust if the authorities intervene to dampen the market. The signs of a boom in the GCC stock markets were all there but, as mentioned before, the QCB and the government did not, perhaps, intervene as they should have as a consequence of the difficulty to reach a balance between development needs and financial stability. Also, the fact that Qatar Exchange has been regulated by a number of

Table 4.4 Avg. Closing Prices of Shares of Listed Companies on Qatar Exchange (QAR)

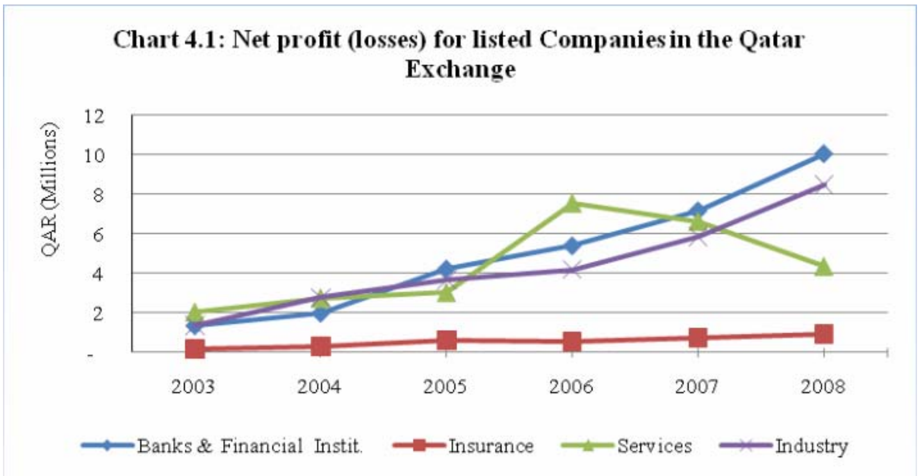
Sector	Listed Companies	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Banks	Qatar National Bank	82.8	126.9	199.7	377.1	237.8	217.3	171.2
	Qatar Islamic Bank	44.0	104.5	219.8	361.9	129.2	156.9	82.8
	Commercial Bank of Qatar	75.5	157.1	206.9	229.7	98.0	186.8	88.3
	Doha Bank	44.0	168.2	223.1	315.2	99.4	85.7	42.0
	Al-Ahli Bank of Qatar	36.0	79.6	89.3	115.0	84.4	87.0	43.5
	International Islamic Bank	61.5	123.9	235.9	525.8	139.0	110.6	58.6
	Rayan Bank	-	-	-	-	18.6	22.9	11.0
	First Finance Company	-	-	-	-	36.6	43.6	24.7
	Al Khaleej Commercial Bank	-	-	-	-	-	14.6	7.2
Insurance	Qatar Islamic Insurance Co.	42.0	131.0	260.0	422.7	115.8	82.3	37.0
	Al Khaleej Insurance	50.0	76.9	200.0	191.5	80.4	101.6	37.6
	Doha Insurance	24.0	41.5	65.7	65.7	35.6	58.0	20.6
	Qatar General Insurance	100.0	165.3	300.0	311.5	152.5	110.6	114.1
	Qatar Insurance	84.5	117.6	260.0	247.8	111.9	170.1	90.2
Industry	Qatar National Cement	134.0	185.5	225.0	260.3	129.4	164.0	99.7
	Manufacturing Industries	32.0	41.5	39.3	104.3	49.5	49.3	36.7
	Qatar German Medical	21.5	31.2	27.8	28.3	15.5	34.0	11.5
	Zad(Qatar Flour Mills)	27.0	29.5	24.5	29.9	25.5	47.0	49.0
	Qatar Industries	-	59.1	61.1	150.0	84.3	154.1	100.6
	United Development	-	29.9	28.5	74.7	34.9	39.7	35.3
	Al-Khaleej Cement Company	-	-	-	-	15.4	26.5	17.4
Services	The Group for Medical Care	25.5	38.1	52.0	31.3	15.7	21.7	9.1
	Salem International Investment	12.1	9.9	12.5	29.7	15.4	18.0	11.0
	Qatar Film Distribution	32.5	40.0	73.0	70.0	57.6	47.0	49.9
	Qatar Real Estate Investment	29.0	39.0	84.7	80.3	42.2	59.7	29.1
	Qatar National Navigation	94.8	127.7	133.0	277.6	112.4	128.4	72.2
	Qatar Shipping	24.7	62.5	113.9	107.1	60.5	65.8	37.5
	Qatar Fuel	28.1	40.8	40.0	126.2	103.5	150.7	130.1
	QTEL	108.5	158.4	229.8	239.9	225.2	228.1	109.5
	Qatar Electricity and Water	30.9	46.1	55.7	77.4	71.9	106.7	111.5
	National Leasing	-	28.5	32.9	63.8	19.2	30.5	18.1
	Qatar Technical Inspection	-	84.2	66.2	48.9	29.0	41.5	22.2
	Qatar Meat & Livestock	-	-	21.0	28.8	11.2	11.4	8.7
	Gulf Warehousing	-	-	23.5	42.4	15.1	58.6	19.5
	Dlala Investment Holding	-	-	10.0	121.1	28.7	32.7	20.5
	Qatar Gas Transport Company	-	-	5.0	48.7	13.2	31.0	21.6
	Barwa	-	-	-	-	29.1	51.2	30.3
	Mannai Corp QSC	-	-	-	-	-	120.0	120.3
	Aamal	-	-	-	-	-	51.5	4.0
	Qatur & Oman	-	-	-	-	-	18.8	8.6
	Ezdan	-	-	-	-	-	-	27.0
	Islamic Securities	-	-	-	-	-	-	48.0
	Gulf inter Services	-	-	-	-	-	-	22.5

Source: Qatar exchange, 2008

institutions which created supervisory gaps in the legal and regulatory environment might also have contributed to the severity of the collapse in the market.

4.2.3 Profitability of Listed Companies

The trading companies on the QE show a steady rise in the profitability of the four main trading sectors with total profits increasing from QAR five million in 2003 to QAR 26.5 million in 2007, more than a fivefold increase. The steady growth of profits is demonstrated clearly in Chart 4.1 for the services, financial and industry sectors, while



Source: Based on previous table (Table 4.4).

profits in insurance have been growing at a much slower pace. Profits in services peaked and overtook both the industry and financial sectors in 2006 but dropped significantly in 2006 and 2007. Overall, the service sector accounts for an average share of 35 percent of total profits, followed by banks and financial institutions with an average share of 32 percent, while industry accounts for an average share of 29 percent, leaving the insurance sector with a low share of four percent, as seen in Table 4.5. The data also shows a concentration of profits in one or two companies in each sector, which is a reflection of the market in Qatar being dominated with a few relatively large, well-established concerns.

Table 4.5 Net profit (losses) for listed Companies in the Qatar Exchange (QAR 000)

Sector	Company	2003	2004	2005	2006	2007	2008
Banks & Financial Instit.	Qatar National Bank	641,123	814,997	1,536,812	2,004,553	2,507,508	3,652,545
	Commercial Bank	248,030	326,706	749,518	891,400	1,390,715	1,702,442
	Doha Bank	214,636	365,625	789,867	743,969	926,464	946,502
	Qatar Islamic Bank	145,031	288,419	511,252	1,003,039	1,255,404	1,642,541
	Ahli Bank	72,570	82,802	141,621	205,741	302,652	425,781
	Int'l Islamic	64,370	83,878	465,624	401,474	479,995	501,158
	Al Rayan	-	-	-	112,819	192,451	917,040
	First Finance	-	-	41,887	80,797	103,859	144,564
	Al Khaleej Bank	-	-	-	-	N/A	103,578
Total		*1,385,760*	*1,962,427*	*4,236,581*	*5,452,792*	*8,159,048*	*10,036,151*
Insurance	Qatar Insurance	98,240	124,053	284,980	388,226	472,682	510,799
	Qatar General Ins.	39,802	108,826	104,403	60,297	125,060	226,267
	Al Khaleej	12,516	28,727	77,625	35,568	77,419	87,015
	Qatar Islamic Ins,	9,925	27,091	123,293	36,641	44,400	68,505
	Doha Insurance	14,296	27,631	42,204	28,883	44,311	47,159
Total		*174,780*	*316,327*	*632,505*	*549,615*	*763,846*	*939,745*
Services	Navigation	181,377	163,079	286,225	260,379	437,939	569,361
	Cinema	4,939	4,369	7,009	6,365	5,995	9,527
	Technical Ins.	2,928	4,650	5,109	6,384	10,178	7,756
	Electricity and Water	384,944	751,241	658,410	771,737	613,611	756,676
	Qatar Shipping	187,606	223,069	417,491	458,588	610,616	517,866
	Real Estate	53,190	56,241	112,520	137,573	299,686	311,433
	Ahli Hospital	1,358	10,317	59,002-	46,973-	24,234-	19,239
	Q-Tel	1,148,822	1,457,159	1,190,447	1,700,440	1,674,310	2,277,212
	Fuel	71,118	105,956	238,462	447,228	616,264	1,205,602
	Salam	23,725	-	75,069	129,767	127,540	153,876
	Meat and Livestock	-	768	22,640	7,556	8,286	39,331
	Wareehousing	-	2,975	11,742	587	1,398	16,530-
	Ijrah	-	9,529	23,955	31,991	54,842	55,117
	Qatar Transport	-	-	49,870	45,291	128,811	129,062
	Dlala Brokerage	-	-	1,113	14,371	25,053	50,494
	Barwa	-	-	-	452,533	529,693	309,960
	Mannai Corp	-	-	-	-	100,517	146,520
	Amal	-	-	-	-	824,086	623,764
	Qatar Oman Co.	-	-	-	-	11,690	3,759
	Azdan	-	-	-	-	561,007	1,357,020
	Islamic Fin. Securities	-	-	-	-	10,533	18,434
	Gulf International		-	-	-	-	*423,407*
Total		*2,004,153*	*2,783,031*	*3,041,060*	*4,423.817*	*6,588,520*	*8,968,886*
Industry	Cement	153,479	170,759	173,763	200,062	355,160	413,645
	AL khaleej Cement	-	-	-	19,810	31,483	34,128
	Zad (Flour mills)	12,171	11,584	9,484	10,219	21,497	47,684
	Industrial Manuf.	50,007	66,705	108,645	116,239	115,635	188,378
	German Medical	3,286	5,155-	1,813	4,433-	1,107-	6,775
	Industries Qatar	1,128,549	2,497,516	3,215,833	3,621,730	4,983,259	7,275,554
	United Development	9,755	31,711	184,999	258,155	339,566	583,467
Total		*1,357,246*	*2,772,737*	*3,694,537*	*4,221,782*	*5,845,494*	*8,549,631*
Grand Total		*4,921,940*	*7,834,524*	*11,604,683*	*14,648,006*	*21,356,908*	*28,494,413*

Source: Qatar Exchange, 2008

Thus, the profits in services is dominated by QTEL, industry is dominated by Qatar Industries Company, while profits in insurance is concentrated in Qatar Insurance. The profits of the banking sector are concentrated in Qatar National Bank and Qatar Islamic bank. The other companies need to be encouraged to invest more in order to expand their businesses, either into new markets or new areas, in order to grow and contribute more to the economy.

4.2.4 Market liberalisation

All the stock markets of the GCC states are witnessing a gradual process of opening up to foreign investors and expatriates, with varying degrees of willingness. Allowing GCC citizens and the expatriate community to participate will attract greater levels of capital, make the Bourse's liquidity levels deeper and increase trading levels. These benefits outweigh any risks associated with greater foreign ownership.

Qatar used to allow only Qatari nationals to trade in shares, except for QTEL and Al-Salam international Investment Company, in which non-nationals were allowed to participate in the subscription of their shares. A new law adopted by the Qatari government now allows foreigners to invest in the securities market, initially starting with GCC nationals and expatriates. It allows expatriates to trade in shares and own up to 25 percent of equity in listed firms. In comparison, Bahrain allows non-GCC nationals to own up to 49 percent of a listed company's capital, a sharp increase from the previous 24 percent, with the exception of two companies that are subsidised by the government, while seven other companies are 100 percent open to foreigners. In Oman and the UAE, non-nationals are only allowed to invest in certain stocks. Since 2000 Saudi Arabia has had the most liberal reform by allowing non-GCC nationals to purchase shares with no restrictions on companies or number of shares. Kuwait allows foreign residents to purchase shares through mutual funds.

Despite the growing openness, intra-regional capital market investors have to process the IPOs in person which makes the process very inefficient. As the IPOs of Dana Gas of the UAE showed, GCC nationals were interested and locked to the UAE to apply for the shares. One way of overcoming this inefficiency is through electronic linkages that are expected to take place among the GCC stock markets. However, opening the market alone will not induce capital to flow in; a case in point is the openness of the Muscat Securities' Market (MSM). The presence of non-Omani investors is negligible. This must be accompanied by the more lucrative, domestic investment opportunities, increasing transparency and disclosure in the market and regulatory frame that protects the ordinary investor. Also, because most promising firms are in the hands of the government; there is a need for more focus and expansion in privatization programmes, to increase the opportunities for investors to venture into these emerging markets.

4.2.5 Market Regulation

In order to overcome one of the obstacles for a stable and efficient stock market, in 2005 the government established the Qatar Financial Markets Authority (QFMA) as an independent and empowered regulatory authority, with the primary objective of implementing a modern regulatory framework to supervise, enhance the competitiveness of the market and attract more business replacing the market's own regulatory system. The QFMA has recently approved the corporate governance code for the Doha stock market. The code is the result of a period of consultation and cooperation between the listed companies, the brokerage firms and the Qatar Exchange. These consultations were in recognition of the necessity of bringing on board the key players in the market as indicated by the deputy CEO of QFMA, Nasser Ahmad Al-Sahibi:

> The stock exchanges, with whom we are working very closely, the brokerage firms and the listed companies, are key players in the Qatari Capital market. They are, also, a key factor in the success of the reform and the implementation of the new market strategy. QFMA counts on the support and collaboration of the brokers and listed companies in order to achieve the ultimate goal of building a robust and a timely well informed capital markets that would provide the corporations with a solid and stable financing mean, and the investors with real investment opportunities based on transparency and market integrity (CPI Financial :2007).

The code addresses the six main elements of companies' governance in the light of international principles and standards. These include: setting an effective framework for governance, shareholders' rights and main ownership functions; fair treatment of shareholders, and protection of minority shareholders; provisions in connection with related parties transactions in particular and to relevant stakeholders in general; disclosure and transparency, accounting and auditing, and Boards' responsibilities (*ibid*). In light of the instability that the market has witnessed since 2005 and the global financial situation, these elements are taking on a new poignancy and immediacy to maintain stability and confidence in the market. However, the success and effectiveness of regulation and such codes depends highly on the availability of expertise and skilled manpower that can take on the responsibility of this supervision to ensure transparency and compliance of the code. Also, the legal structure needs to develop to be able to cope with the enforcement of the rules and regulations of the code**.** In other words, it is not enough to enact codes if the infrastructure that can support it and make a success of it does not exist.

4.3 The Integration of GCC Stock Markets

The expansion experienced by the Qatari stock market is in line with a similar development in the other GCC states. That growth has coincided with the higher oil prices that have been seen over the past few years. GCC capital has been held abroad in the past and the region's markets were not seen as attractive to GCC nationals. The crash of Kuwait's Souk Al-Manakh in 1982 had a negative impact on investment behaviour in the region. However, market capitalisation has increased substantially in recent years. In the period 2002-2004, total GCC market capitalization increased by 227 percent, from USD 163 billion in 2002 to USD 533.7 billion in 2004, the highest market growth of around 281 percent was experienced by Qatar from USD 10.6 billion to USD 40.4 billion (Arab Monetary Fund: 2006). This has reversed a trend of absorbing excess liquidity abroad rather than in the region. GCC investors have favoured equity-based investments which have outperformed other asset classes such as bonds.

The plunge of between 14 and 45 percent that GCC markets experienced in the first half of 2006 (Dubai's market was hit hardest declining by 45 percent, followed by Abu Dhabi with a slump of 33 percent, Saudi Arabia fell by 27 percent, Qatar by 20 percent and Kuwait by 14 percent) is attributed in part to the lack of a proper regulatory frame that would have allowed some insider trading to occur without sufficient penalisation, lack of transparency and accurate company reporting, in addition to speculative behaviour (AMF Info: 2006). Consequently, many small investors were left in ruins. That explains the emphasis on improvements in compliance and a strengthening of regulations of the GCC stock market as essential elements to create a stable investment climate. One of the major objectives of the GCC common market is to establish a common supervisory and regulatory body to monitor the GCC markets; such a move would be instrumental in stabilising and developing the regional investment market. The former Qatari Minister of Business and Trade Sheikh Mohammed bin Ahmad bin Jassim Al-Thani, speaking at a conference on GCC stock markets said:

> Cooperation among the Gulf stock markets is essential to overcoming the present and future challenges to these markets. Common reforms are needed to develop a stable and integrated regional equity market with depth and breadth to attract regional and international capital (Akeel: 2005).

However, the area of integrating the region's markets through institutional and regulatory coordination has seen little progress with little contact or coordination across GCC stock exchanges. Substantial improvements in the flow of information to investors, proper auditing procedures, issuance of standardized financial statements and disclosure requirements will help increase confidence in the region's capital market and might persuade Gulf nationals to repatriate some of their assets that are held abroad. In mid 2005, a meeting was held in Riyadh for the GCC to consider steps towards establishing a joint stock market for the GCC countries and a joint bonds market**.** According to the director of the economic administration of the General Secretariat of the GCC "It was the first meeting for negotiating, exchanging opinions, and coordinating between the gulf market's rules and regulations" (*ibid*). The goal is not to have one market but to unify the procedures and make the rules and regulations as comparable as possible, as well as to ease the procedures for Gulf investors to enter the stock markets. This might be considered a first essential step towards the more desired goal of market integration in order to improve the chance of harnessing the full potential that exists within the GCC region. The acquisition by QTel in 2007 of a 51 percent stake in Kuwait's second mobile telecoms operator Wataniya Telecom for USD 3.8 billion, which represents the largest ever-transaction of shares in a Kuwaiti listed company is an example of the need for the region to move towards mergers and acquisition to strengthen the economic future of the region (Arabian Business: 2007).

4.4 The Bond Market

Bond market development is associated with a number of benefits: expanding the range of financing opportunities for the private sector, offering an alternative to relying on bank loans and helping savings to be used domestically. All of these benefits are paramount for the success of economic diversification and expanding private sector interests in Qatar. This type of funding is expected to attract the attention of project sponsors, "As bank liquidity has diminished, the bond market has opened up another avenue for funding projects" (MEED, July 2009). It is also an area in which governments can intervene in order to stimulate and influence economic development. Classic examples of the success of governments in developing a bond market are Malaysia and Korea. The governments of these two countries played key roles as issuers, regulators and promoters of the bond market. The Qatari government has been involved in these aspects of promoting the market but the impact is still limited. Below is an analysis of the main features and contributions of this market to the Qatari economy.

4.4.1 Growth of the Market

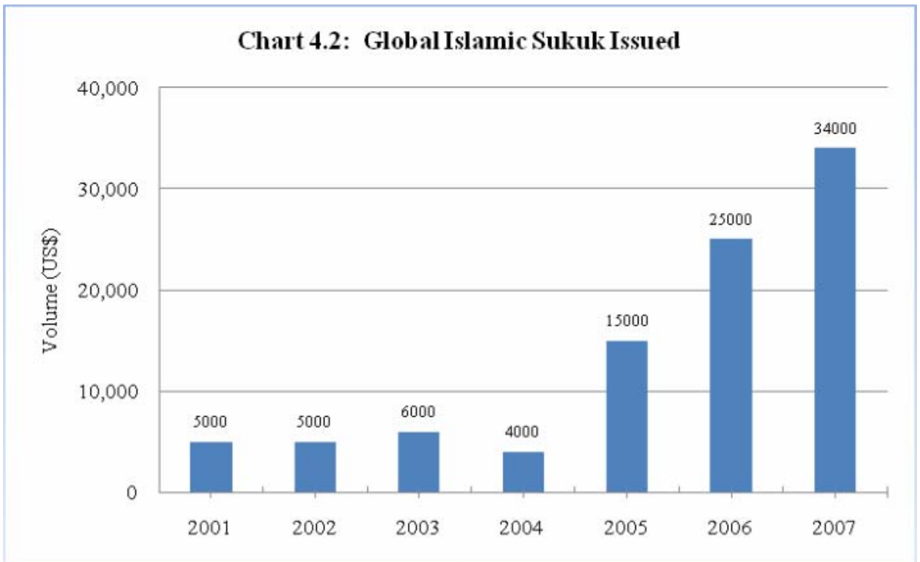
The limited size of the debt market in Qatar, as in other GCC countries, is understandable in economies where the private sector is small in comparison to the public sector and wealth is concentrated in the hands of the state. So the issuance of government securities has been limited in comparison to other global markets, and hence the market lacks a benchmark yield curve for pricing debt and other financial instruments. Although the majority of securities in the Qatari market have been in the form of sovereign bonds and notes, they have not yet had the impact needed to develop a local yield curve. There is a need to expand the volume and the range of maturities of government bonds to help develop a secondary market and a yield curve. Such a yield curve is essential for the development of corporate bonds.

In recent years, the GCC region in general has witnessed a tremendous expansion in corporate bond issuance. In 2005, the total issuance was USD 13.5 billion, with corporate bonds accounting for USD 3.2 billion, rising to USD 47.8 billion in 2007, of which corporate bonds accounted for USD 23.7 billion (Reuters: 2007). That is quite a rapid increase in the share of corporate bonds rising from 24 percent to 50 percent which more than doubled within a very short time span. The enhanced popularity of this type of fixed income security was possibly caused by two major factors: excess liquidity and the recent volatility experienced by most GCC stock markets which “have raised investor awareness of fixed-income products as a means of steady return” (*ibid*).

After a period of steady growth, the market saw a slowdown in 2007 and 2008. However, several recent regional deals have boosted confidence in the market including Qatar’s Ras Laffan Liquefied Natural Gas Company which was eight times oversubscribed for its USD 2.23 billion bond to pay for the final part of the work on its liquefied natural gas trains (Kawach: 2009). Another deal is the Dolphin Energy project which will supply Qatari gas to the UAE and Oman via an undersea pipeline; the Dubai-based company launched a USD one billion bond to part-fund the total cost of the project of USD 3.5 billion This was followed by two successful bond launches, the first for Aldar Properties which had orders of USD 4.8 billion for its USD 1.25 billion bond while Dubai Tourism and Development Investment Company attracted USD four billion in orders for its USD one billion bond (MEED: 2009, p 18). The size of the projects in Qatar and in the Gulf region makes it imperative for their sponsors to be able to access as many sources of funding as possible. Also, bond financing has the advantage of being offered at longer-term finance than banks because institutional investors do not have to set aside equity when they lend, and because of the current state of banks, bonds are competing with banks on price and are able to offer roughly comparable prices (*ibid*: p20).

4.4.2 Growth of *Sukuk*

A distinguishing feature of the development of the bond market is the expansion in Islamic bonds known as *sukuk*. As shown in Chart 4.2, the global



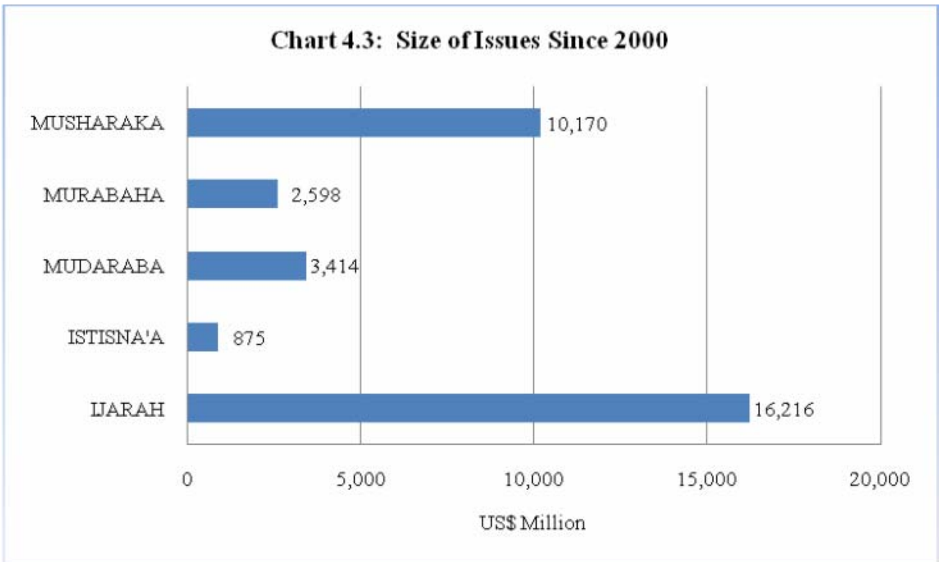
Source: UBS Investment Bank, The Soaring Sukuk Market, November 2008.

expansion of *sukuk* issuance increased sevenfold between 2001 and 2007. Between 2004 and 2007, growth rates were staggering, with a total issuance growing year on year by 275 percent in 2005, 67 percent in 2006 and 36 percent in 2007. These results, though impressive, came at a time of when access to credit was easy and benefited from oil prices that were at historical highs. This led to ever-increasing issuance, especially from the GCC. The market is less than a decade old; the first GCC issuance was in 2001 by the Bahrain Monetary Agency, for USD 100 million, growing to over USD 12 billion in 2006 (Reuters: 2007).

The Investment in *sukuk* is defined by the Accounting and Auditing Organisation of Islamic Financial Institute, AAOIFI, as:

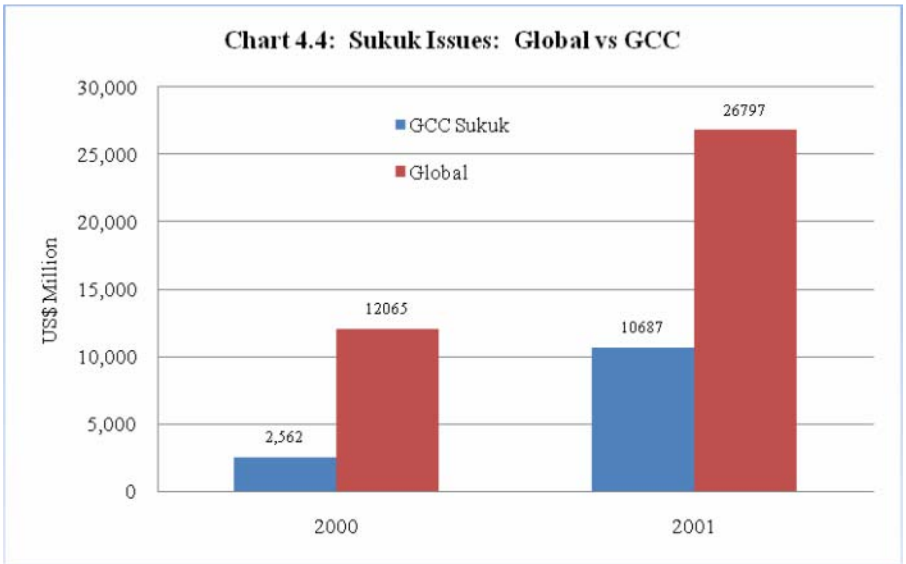
> Certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in ownership of) the assets of particular projects or special investment activity, however, this is true after receipt of the value of the *sukuk*, the closing of subscription and the employment of the funds received for the purpose for which the *sukuk* were issued (Diab: 2004).

In other words, these are investment certificates which represent an undivided beneficial ownership of an underlying asset that generate a *Shari'ah*-compliant source of income. It is important to make this distinction, as it is not an alternative to an interest-based security. This structure is recognised as enhancing the security of the investment and reduces a typical investor's risk exposure as it is involved in the funding and/or the production of real assets (Chartered Financial Analyst, 2007, p 35). Of the 14 structures of *sukuk* defined in accordance with the classification of AAOIFI, only five are being used: *Ijarah* (leasing), *Musharaka* (partnership and joint stock ownership) *Mudaraba* (profit-and-loss sharing contracts), *Murabaha* (instalments) and *Istisna'a* (futures). Chart 4.3 clearly shows that *Ijarah* is the most popular type with a share of 49 percent followed by *Musharaka* with a share of 30 percent of the total.



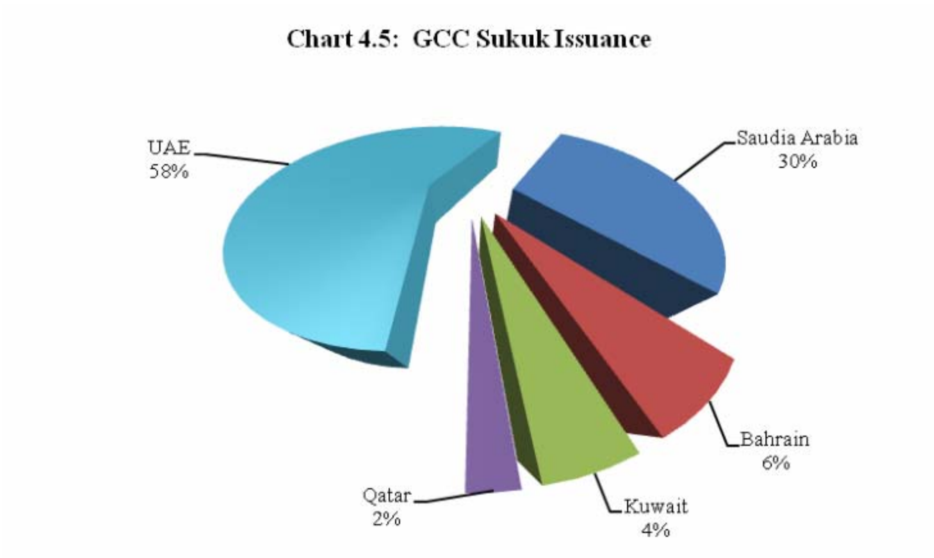
Source: Omer Daouk, Analysis of the Sukuk Market, April 25, 2007 SHUAA Capital, Dubai

The GCC is becoming a centre of *sukuk* issuance and is starting to take a bigger share of the global market, as seen in Chart 4.4. It is also starting to develop secondary trading; a crucial element for the continued growth of this market. In 2007, the GCC market surpassed Malaysia with a total issuance of USD 13.2 billion, compared to USD 9.7 billion. However, Malaysia is still dominant in terms of total sales; more than 60 percent of outstanding Islamic bonds were denominated in the same year by the Malaysian ringgit.



Source: Ibid.

The market is also showing a diversification in issuance. The United Arab Emirates has dominated the market; however Qatar and Saudi Arabia are becoming more prominent issuers. Qatar alone has plans to raise up to USD 15 billion in 2009, out of a total estimated corporate bonds for the GCC of USD 50 billion (Zawya: 2008). Chart 4.5 shows the relative share of some of the countries of the Gulf region; it is clear that the UAE led the way, followed by Saudi Arabia.



Source: Opcit, UBS Investment Bank.

In 2003, Qatar issued what was then considered the largest sovereign *sukuk* of its kind, for USD 700 million. This issuance was accessible to GCC investors. The joint lead managers of the issue were HSBC Bank and the Qatar International Islamic Bank, with the co-managers from the Abu Dhabi Islamic Bank, Gulf International Bank, Kuwait Finance House, Commerce International Merchant Bankers of Malaysia, the Islamic Development Bank and the Qatar Islamic Bank, with payments being made under an *Ijarah* agreement, with HSBC Bank acting as payments administrator (Adam & Thomas p13). A year later Dubai Civil Aviation surpassed that by issuing one billion US dollars of *sukuk,* followed in 2006 by USD 3.5 billion by real estate developer *Nakheel* Development, one of the biggest Islamic finance deals to take place in the Gulf (Reuters: 2007). It is interesting to note that this *sukuk* is part of the request by Dubai Department of Finance for a standstill on all Dubai World's debts. This bond is payable on December 14. In fact, Nakheel has asked for all three of its *Shariah*-compliant bonds, worth USD 5.25 billion to be suspended from trade "Until it is in a position to fully inform the market" (Kerr & Wigglesworth: 2009). This latest development in the financial crisis that has gripped Dubai might have repercussions on the issuance of *sukuk*.

The greatly-increased interest in *sukuk* can be attributed to the huge surplus of cash sitting in Islamic institutions, waiting to be tapped by new financial instruments. Assets of Islamic financial institutions, estimated at USD one trillion in 2007 and growing rapidly because of high oil prices, with over USD 300 billion invested in a *Shariah*-compliant manner, with market capitalization of Dow Jones Islamic index of more than USD 20 trillion (Haron: 2008, p7). The widespread use of *sukuk* is contributing to the growth and development of an Islamic capital market and provides a new source of funds for vital infrastructure projects, as well as helping to keep funds working for the benefit of the local economy.

An indication of the growth in importance of this particular type of bond issuance is the listing of the first *sukuk*, on 20 July 2006, on the London Stock Exchange with a value of USD 200 million by a special-purpose vehicle for National Central Cooling Company, Tabreed (Practical Law: 2006). According to Luma Saqqaf, head of Islamic finance group at Linklaters (who advised Tabreed on the Issuance): "The issue is a landmark transaction that highlights the continued growth in the financial activity in the Middle East and the new popularity of London listings among Middle East issuers" (*ibid*.) Two months prior to that, in April 2006, the Dow Jones Citigroup Sukuk Index was published for the first time, with the stated objective of measuring the performance of global bonds complying with Islamic guidelines. It will provide a benchmark for investors, which is lacking in the capital market and which is essential in order to encourage global trading in *sukuks*.

The first-ever Qatari corporate Islamic bond was issued in 2006, by Qatar Real Estate Investment Company (QREIC). The finance arrangement, valued at a total of USD 375 million, is being led by Qatar National Bank and its subsidiary Qatar National Islamic Bank in alliance with Dubai Islamic Bank, Gulf International Bank and Standard Chartered Bank. The spread of risk among a number of banks is normal for such a large corporate funding. Commenting on the deal, Ali Shareef Al-Emadi, CEO of Qatar National Bank, said:

> We take pride in introducing the first corporate *sukuk* in Qatar. This is clearly a testimony of the market's readiness for more sophisticated products that address the evolving financing needs of companies in Qatar. It also reflects Qatar National Bank's commitment to providing Islamic finance solutions, thereby providing a new dimension to the Islamic banking sector in the region that holds much promise and growth for the future (AMF info: 2006)

This is an indication of the growing importance of both the Islamic finance market and the real estate market in Qatar. The *sukuk* lends itself well to investments in the real estate market because it is asset based. Sheikh Khaild bin Khalifa bin Jasim Al-Thani, Managing Director of QREIC indicated that:

> The financing deal will play an instrumental role in our next phase of growth as we forge ahead in addressing the urban needs of Qatar. We are excited to raise funding through the first corporate sukuk issue from Qatar. We aim to continue being involved in the region's rapidly growing Islamic Finance Market (*ibid*).

Although the real estate market is slowing down and there are some delays in projects, not a single project has been suspended. This slowness is incomparable to the burst in the real estate bubble that propelled the frenetic expansion of Dubai in recent years. More than 400 projects in the UAE, with a total value of USD 300 billion, have either been put on hold or cancelled (Estates Dubai: 2009). This perhaps attests to Qatar's more prudent and conservative approach in its development and expenditure patterns. Such prudence will undoubtedly help in maintaining the growth and stability of the economy in a very difficult global market.

Qatar Islamic Bank (QIB) has launched the Europe-based Global Sukuk Plus Fund through its London-based affiliate, European Finance House (EFH), designed to originate S*hariah*-compliant investment products. The QIB and EFH joint-fund will be invested in *sukuk* issued by sovereign, quasi-sovereign and corporate issuers and sourced globally. The investment range of this Sukuk Fund spans across six major Islamic financial markets and is easily accessed via each of QIB's affiliates in addition to EFH, including Arab Finance House (AFH) in Lebanon and Asian Finance Bank (AFB) in Malaysia. This move attests to the increased interest in *sukuks* and their potential massive market. According to Jean-Marc Riegel, QIB's General Manager,

> The growing interest in the Islamic financial market has demanded that we draw upon the innovation of the QIB network to develop investment products which will thrive within the current environment. The Global Sukuk Plus Fund is a very forward-looking product for the s*hariah*-compliant market and a strong option for clients (AME info: 2009).

The opportunities presented by the current situation in the global market for the GCC economies to capture are enormous. As eloquently put by Abdulrahman Ahmed Al-Shaibi, director of finance at Qatar Petroleum and board member of Qatar Financial Centre (QFC) Authority, during his address to the FT "Rethinking the Future Finance" conference in Doha, September 2009:

> The Gulf is at the forefront of a new era in financial services that will see Islamic finance play a key role in shoring up the fragile world economy. The global crisis had gifted the Gulf a greater stake in the world economy. We now own some of the world's leading companies while we have been protected from the worst of the financial tsunami (Fraser: 2009).

He also pointed out that "Islamic finance is ripe for further development. With banks still reluctant to lend, the *sukuk* is a viable and reliable alternative. There is a lot of value in this, and the markets are not taking full advantage of it (*ibid*). No doubt the potential that exists due to the West's frozen credit markets presents a prime opportunity for the more widespread use of Islamic finance. The tenets of *Shariah* compliance (prudent lending, shared risk and a ban on interest) would appeal to investors burnt by the global crisis.

4.4.3 The Impact of the Global Financial Crisis

As the GCC bond market in general remained strong even after the initial impact of the financial crisis in 2007 there were those who thought that Islamic finance could withstand this downturn intact, due to the nature and features of Islamic banking and finance, and therefore of the *sukuk* market. This led to some unreasonable expectations for the industry. Some thought that Islamic finance had successfully separated from conventional global credit markets, while others claimed that Islamic markets were now mature, independent markets, not related to the price of oil. Another view expressed was that lower leverage and emphasis on holding and selling real, tangible assets would save the industry from the full impact of the financial crisis and subsequent credit crunch (MENA Report: 2009). Essentially, all of the above emphasise the fundamentally different natures of Islamic finance and conventional finance.

However, the GCC aggregate bond market, despite its initial robustness in the face of the global financial crises, plummeted in 2008 by 62.4 percent to USD 18.1 billion compared with the amount raised in 2007. The *sukuk* global total also showed no immunity from this global downturn and, in 2008, also witnessed a drop of 66 percent in total issuance compared to 2007. The impact was felt across the board, with GCC issuance dropping by 51 percent to USD 9.06 billion while Asian issuance dropped more severely by 76 percent with issuance falling to USD 6.57 billion (*ibid*). This slow-down is not only attributed to the impact of the global financial market, but also to the continued legal uncertainty, lack of regulatory support and legislation and lack of transparency, in addition to the instability caused by the debate on whether to delink and to de-peg the GCC currencies from the weakened dollar. All these factors played a role. They made raising funds more challenging and reduced confidence in the markets and in borrowers' ability to repay their debts.

However, mainly due to the enormous currency reserves accumulated in GCC countries over the past few years, the severity of the crunch is not comparable to that experienced by Western credit markets. Also the GCC governments are very wealthy and can bail out financial institutions. As mentioned before, the Qatari government purchased the investment portfolios of seven Qatari banks in order to revive lending and support the stability of its financial system. Also, the expected growth rates in the GCC economies, especially in Qatar, will sustain the demand for bond issuance especially with the considerable amount of projects planned in the country and the region as a whole.

4.4.4 SMEs and the Bond Market

In order for the bond market to make an impact on the private sector, there is a need to find mechanisms where SMEs can have better access to funds which is usually restricted to such firms, especially in comparison to large business. The growth and expansion of these firms is essential for job creation and wealth redistribution; Qatar, like other GCC countries, suffers from a high concentration of wealth in the hands of a few firms and individuals. One innovative way that has been successfully used in China to overcome this major constraint on the development of SMEs is to issue bonds jointly. Twenty SMEs in Shenzhen jointly issued a bond during 2007 to raise funds from institutional investors. The five-year, fixed-rate bond, with a coupon rate of 5.7 percent and an AAA credit rating – the highest available – sold out on the first day of issuing. The Government acted as the managing underwriter of the collective bond and provided guarantees (China Daily, 07 Nov, 22).The Qatari government has the financial ability to support a similar scheme; however, the management of such an innovative process might be a constraint. Nonetheless, it is an aspect of fund-raising that is worth pursuing especially as this type of "joint bond issuance will offer new options for SMEs to raise funds directly in the capital market and it can be a more convenient and economical financing channel than bank loans" (*ibid*).

SMEs do not have the financial clout or business track records to issue bonds separately and in order to grow and compete they need to be able to raise the necessary funds. Issuing bonds jointly allows them to do just that.

4.5 A Regional Bond Market

The current state of global financial markets coupled with the potential that exists in the markets of the GCC makes for a very strong case for the creation of a regional bond market. Such a market could take better advantage of this prospect, in particular, in *sukuk* issuance. In that respect, the experiences of the Asian Bond Market Initiative and the European Monetary Union are of immense value and relevance.

The Asian Bond Market Initiative resulted in the launching of the Asian Bond Funds (I and II) in order to promote bond market development in Asia. Similarly, the creation of the European Monetary Union significantly added momentum to the growth of the European bond markets. The Asian Bond Funds were created to respond to the need to encourage local financial intermediation and to invest the large Asian savings within the region; these two circumstances also exist in the GCC region, and a similar initiative can prove as successful. The European Monetary Union shows how the introduction of the single currency enhanced bond issuances in Europe; the advent of the Euro in January of 1999 was accompanied by a doubling of private debt issuances – from USD 273 billion in 1998 to USD 679 billion in 1999 (Ong & Luengnaruenmitchai, 2006). This growth had a positive impact on broadening the range of bonds issued: while the European market was previously dominated by AAA and AA issuers, the amount of single A-rated paper increased substantially after the advent of the single currency, thus widening participation of a variety of businesses (*ibid*).

The monetary union agreement of the GCC region was planned for January 2010. In fact, efforts are already underway to harmonize several areas of the economy such as some financial regulations, tax codes, accounting conventions, as well as payment systems. Although these are important from the perspective of the monetary union, they are also beneficial for the creation of a regional bond market. Thus, similar developments to those that occurred after the European monetary union can take place in the region facilitating further the expansion and growth of the bond market. However, the monetary union agreement has been extended to 2015, despite the GCC Secretary General announcement in October 2007 that the January 2010 deadline would remain in place. Member states have been unable to meet the convergence criteria. These included maximum levels of budget deficit; public debt; current account deficit; interest rates and inflation (modelled on the EU's convergence criteria, the two in fact are almost identical).

A regional bond market can also be better equipped to overcome the challenges and constraints that exist at present in the bond market in a unified and coordinated fashion. These include, firstly, overcoming the dominance of Islamic banking. Despite the expansion of *sukuks* issuance, their share in total *Shariah*-compliant assets is only 14 percent (of the USD 700 billion in total global Islamic assets for 2007) while Islamic banking accounted for a share of 79 percent. In such regional markets, governments and companies from across the region would be able to attract a wide pool of institutional investors, not only from neighbouring countries, but also from other parts of the world. This would also help alleviate some of the limitations imposed on most Gulf States, including Qatar, by the limited size of the local market.

Secondly, a regional market can cope better with the decline in *sukuk* issuance induced by the global financial crisis, especially as the factors driving this market are common to all GCC countries. Most notable among them is the planned large-sized inward investments which require large-scale financing and cover a wide range of areas such as infrastructural investments; tourism; hydrocarbon and ports. Also, GCC governments are very keen on sponsoring and supporting the creation of a liquid corporate bond market as part of the process of creating more diversified regional financial centres.

Thirdly, a regional market is more suitable for taking the necessary measures that are immensely important for a well-functioning and competitive market such as the creation of a regional credit guarantee agency, a regional bond rating facility and clearing and settlement capacity. In this regard, the establishment in July 2005 of the Islamic International Rating Agency (IIRA), based in Bahrain, is a welcome development. The IIRA's stated mandate is to assist in the development of the regional financial markets by providing an assessment of the risk profile of Islamic entities and instruments, thus making the market more competitive (Raphaeli: 2007). Another factor that increases the competitive edge of a GCC regional bond market, especially in relation to the Asian market, is the issuance of *sukuk*, generally in dollars, gaining a global investor base with nearly 80 per cent of Islamic bond issuance acquired by foreign investors (*ibid*). However, this might change when and if the planned currency union takes place.

Fourthly, although the *sukuk* market is considered one of the most innovative Islamic products that have come to the financial market, there is disquiet in some quarters about its level of compliance with *Shariah* law. This questioning was brought about by Sheikh Muhammad Taqi Usmani at the Accounting and Auditing organisation for Islamic Financial Institution annual event in Bahrain in 2007, who claimed that most of the current structures do not comply with Islamic law (Thomas: 2007). Clarifying the Islamic legitimacy of the *sukuk* market is relevant to the future development of the market and is part and parcel of the structuring of this new market and coordinating and standardising practices in accordance with *Shariah* law. As the Sheikh indicated, the questioning was meant to assist the Islamic financial community to achieve conformity and compliance with *Shariah* law. He emphasised that the council’s obligation is

> To bring about mutual conformity or approximation between the conceptualisations and the practical applications of *Shariah* supervisory boards of Islamic financial

> institutions so as to avoid inconsistencies and contradictions between *fatwa* and implementation of the institutions (*ibid*).

This focuses attention on the need to develop a regional know-how in Islamic securitisation structuring and the necessary compliance of securitisation transaction with the *Shariah*. This is better served through a regional framework which can make the market more appealing and more competitive to global investors by standardising and increasing the confidence of the legitimacy of the *sukuk* in order to facilitate secondary trading. *Sukuk,* unlike conventional bonds, lack a strong secondary market and most buyers hold the asset to maturity. Transferring of ownership needs to keep occurring from buyer to seller to expand the market beyond *sukuk* going only to big financial players of high–net individuals, European Funds and Asian Funds - it has not yet gone to the retail market. Also, a strong secondary market will attract other important institutional investors such as pension funds as well as treasurers of banks in the Middle East, who are starting to show interest in the market.

Fifthly, special attention needs to be given to the area of regulation. Qatar had plans to adopt a single, integrated financial regulatory body to supervise all banking, insurance, securities asset management and other financial services by merging banking supervision sections of Qatar's Central Bank, the Qatar Financial Centre Regulatory Authority (QFCRA) and stock exchange regulator Qatar Financial Markets Authority (QFMA) into a single integrated regulator. As indicated by Qatar Minister of Economy and Finance, Youssif Hussain Kamal:

> This initiative aimed at creating a best-practice legal and regulatory environment for Qatar's entire financial sector, illustrates the government commitment to the development of a thriving financial services industry (Zawya: 2008, October).

Whilst planning for a unified regulatory system, Qatar was following in the footsteps of other countries, primarily the UK. For many years, Britain adopted a hands-off approach to regulation of the financial services in the belief that the "City" fully understood that the government would intervene if the "City" did not voluntary adhere to prudential practise (Qatar Today: 2008). It was only in the mid 1980's, after a series of financial scandals, that the Financial Services Act of 1986 came about in an effort to bring systematic regulation to the market. However, the Act was problematic; too vague, still pursuing a light touch regulation and the regulators lacked the resources and experience to effectively regulate (*ibid*). After the recession of the 1990s, the Financial Services and Markets Act of 2000 was produced as a comprehensive piece of legislation for the financial market. However, its apparent failure to regulate and prevent the collapse of Britain's financial system is dampening the appeal of a unified regulatory body.

One could argue that the apparent failure of the regulatory system in Britain does not necessarily mean that the system *per se* was at fault, rather the system was undermined by the lack of political will to scrutinise compliance. Nonetheless, scepticism abounds at present, and the Qatari government has postponed its plan for a merger, citing the uncertainties of the global market and the need to reassess the validity of following international regulatory models as its main reasons. As indicated by the Chairman of the QFC, "The three regulators are getting on and doing our jobs separately, we have been in a holding pattern for some time now" (Qatar Today: 2009). He also emphasised that there is a "need to examine the relationship the single regulator will have with the Central Bank and Ministry of Finance, we've seen many regulators around the world struggling with these issues and it's sensible to wait for some of the results of these inquiries presently" (*ibid*). There are also other factors that might have played a role in this u-turn, including the lack of manpower specialising in this highly complex practice as well as lack of readiness of the legal system to cope with complex financial activities and possible financial crimes.

It is understandable, with the current state of the global financial system, that there will be a lot of discussion and uncertainty about regulatory models. However, a unified regulatory system is still paramount to implement stricter rules in terms of stronger prudential norms, tougher licensing requirements, enforcement powers, clear capital to risk requirement, enhancing accounting standards and greater scrutiny of unusual products. Also, with an integrated regulation system there is less likelihood for soloing between the different regulators, so they can share information better, and there is less compartmentalisation of information, all of which is necessary for effective regulation.

Finally, the GCC countries should also consider strengthening their ties with the other prosperous Islamic financial centres, such as Kuala Lumpur, Labuan, and Singapore. Some steps in this direction have already been taken by Bahrain with the listing of a Malaysian sovereign *sukuk* on the Bahrain Stock Exchange in September 2003. Islamic finance is a global trend supported by the large Muslim population in both Asia and the Middle East and global cooperation is essential. This cooperation will also help stimulate the secondary market, which is paramount for its continued growth and contribution to the economy. The launching of India's Financial Technologies of a new bourse in Bahrain in 2010 called the Bahrain Financial Exchange to provide a secondary market for Islamic bonds is a great step forward for this market.

4.6 The Private Equity Market in Qatar

Private equity is not tradable and is defined as equity securities of unlisted companies characterised by being long-term investments and is far less liquid than publicly-traded stock. Its inclusion in the analysis is an indication of the widening of financial instruments available in the Qatari economy and for its importance in widening private sector involvement in the economy.

The GCC region has, for a long time, been a source of capital for private equity firms but is now becoming a destination for private investments. This is due primarily to the billions governments are investing in infrastructure, much of it in transportation and financial services, as an essential part of their diversification strategy and the downturn in the global market making the region a very attractive alternative for local and international investors. Although this market accounts for a small proportion of the region's economic activities, it is developing fast due to the combined influence of the above-mentioned factors and, more importantly, its potential growth is tremendous and the benefits that such a market can bring to the local businesses are substantial. Thus we see the money raised in the MENA region through this market has been on the rise, especially of late. Between 1994 and 2005 USD 5.8 billion were raised, of which 41 percent was raised in 2005, growing to USD ten billion for the GCC alone in 2006 (Ithmar Capital: 2009). That figure represents half of all the funds raised in the region and less than a third of the total of USD 33.2 billion raised in emerging markets of Asia, Eastern Europe, Latin America and the MENA region altogether: a sign that business and government are taking advantage of this market to meet their capital requirements, especially with the volatility of the stock market (*ibid*). Thus, in contrast to the global dwindling of private equity deals, as a result of the credit crunch, the MENA region private equity market has managed to achieve record growth.

As for Qatar, this market is still small, but has potential for further growth. Recently, the Qatar Islamic Bank signed an agreement with Islamic investment bank QInvest and Silver Leaf Capital to establish a USD one billion private equity fund that will adhere in part to Islamic principles. Salah Jaidah, the CEO of Qatar Islamic Bank (QIB) describing the deal said,

> This is the first large-scale private equity fund ever in Qatar. Our objective is to invest in diverse sectors that will allow technology migration and transfer of know-how to Qatar and we already have in the pipeline about USD 300 million of investment opportunities that DIA is evaluating (Arabian Business: 2008).

QIB will be the anchor investor in the fund and will act as the lead distribution agent in Qatar and senior distribution agent outside the country using QIB's affiliates in the U.K., Lebanon and Malaysia.

There are two particular benefits associated with this market that are of relevance and significance to the Qatari economy. These are, notably, the ability of private equity to facilitate the move away from the business structure that characterises the economy of family-owned and state-owned Qatari enterprises to open the market and stimulate the growth of business across an improved diversity of markets. Traditional family-owned businesses and agency-based enterprises account for over 86 percent of all commercial activities in Qatar; this rate is slightly higher for the GCC region where over 90 percent of all commercial activities are family-owned (Kooky plan:2009). These firms hold combined assets of more than USD 500 billion and employ 70 percent of the workforce (*ibid*). However, because these firms mostly represent international brands and are more sellers and distributers, their engagement with R&D is very little and they are quite sensitive to changes abroad. Thus many of them will be influenced by the downturn in the global economy and their future is linked more to the future of these international brands and their ability to survive the crisis.

Private equity, which has been the foundation for success for family firms all over the world, can be of great benefit to these firms. Family businesses in Europe which partnered with equity firms increased exposure to new markets by 60 percent and outperformed their competitors (Ithmar Capital: 2009). Also, private equity is well-suited to support investments in innovative sectors and entrepreneurship. One such market that Qatar is showing interest in is the blue chip. These are very weak in the GCC because of the bias towards the agency-based business model. Mikko Suonenlahti, General Manager at Qatar Capital Partners, a Doha-based venture capital provider, confirms the emergence of interest from technology firms. He says, "W*e* have strong demand from Arab technology developers in the US and in Europe wanting to relocate back to the region. They have not previously had a chance of starting a tech company in the GCC countries" (Watts: 2007). In other words, private equity is most appropriate to support diversification of the economy by expansion in technology-related and innovative areas as well as to encourage a culture of entrepreneurship.

However, for these opportunities to be captured, local businesses and the Qatari government need to work together to overcome the obstacles which are limiting this market's realization of its full potential. In fact, these obstacles are common to all GCC countries, and the most effective way of addressing them is by working collectively to understand the possibilities that exist in the market for the region and its associated benefits, and cooperating with local businesses in order to determine the best ways to reap these benefits. The most important of these obstacles are analysed in the following discussion:

Diversification and Privatisation: Although privatization is attracting many investors to the region, there is a need to move these investors into new areas and not just invest in what was previously state-owned; the government needs to encourage investors to move away from this dominant interest which limits economic diversification and from public funding which accounted for more than 60 percent of new funds raised by regional equity firms in 2006 (Ithmar: 2009). This is not an easy task since the GCC identified assets for privatization valued at more than USD one trillion and infrastructure financing (due to the growing pressure on public resources as a result of population growth) will maintain private equity interest in these traditional sectors. However, the benefits of private equity would be best actualized if investors' interest widened to include other sectors and new areas and that needs greater understanding of the tremendous possibilities and opportunities in the GCC economies. There is a clear knowledge gap among the business community which needs addressing if these economies are to fulfil their strategy of economic diversification.

Restructuring Family Businesses: Private equity is the key to aiding the transformation of family-owned businesses into corporate concerns, and that transformation is necessary in order to deal with the three interrelated issues of ownership, management and succession. There is little separation in Qatar, as in other GCC countries, between ownership and management of firms, with succession passing down through the generations. This model is limiting the competitiveness of these firms and their exit strategies - two essential ingredients for the long-term survival of family businesses. In that sense, private equity can restructure a business in such a way that adds value, makes it more competitive by opening new markets or expanding into new areas and ensures the survival of the business. Most businesses in Qatar are in their second generation; data from developed countries indicates that only 30 percent of family businesses survive into the second generation and less than six per cent make a successful transition beyond the third generation (Ithmar Capital: 2009). Thus, strategies and structures of finance and operation must be put in place to avoid that eventuality. Other benefits of restructuring firms include the positive impact on the stock market through listing these companies and new IPOs offers as well as decreasing the dependency of firms on banks and personal ties between owners and bankers where money is lent to companies with strong asset coverage and shareholder support rather than effective corporate governance process. But to fully realise these benefits, family businesses need to address these three issues of ownership, management and succession themselves. There is already a realisation of the need for internal controls and a better governance system, however, many of these businesses are unaware of the private equity industry and how to access it and benefit from it. So it is important for governments and private equity firms to highlight this market and for private equity firms to link with investors, especially within a culture where personal relationships are the key drivers of negotiations and deal making.

Regulatory Environment: This has been identified by equity firms in the region as one of the main obstacles to the development of the market (Eid: 2006, p14). A change is much needed in the approach of businesses to regulatory compliance and transparency processes. Firms in Qatar are characterised by an informal decision-making process, lack of transparency, weak auditing and the lack of a formal corporate governance system, particularly when it comes to fraud prevention programs. About 70 percent of GCC businesses have no such programme in place, and investor relations are not a priority (*ibid*). GCC central banks have improved the governance requirement by requiring businesses to establish disclosure in financial statements and implement board-level audit and create risk management processes. However, the levels of transparency and regulation still need to be improved greatly to give confidence to private equity firms and increase investor interest and allow for better assessment of the potential of firms and exit processes. Also, overcoming very strong cultural factors, whether in the manner of running a business or in aversion to change, fear of loss of control of a business and in complying and adapting to stringent business regulations and rules, is a slow and difficult process. Private equity can change businesses from a one man show to an institution but that requires some tremendous changes in the cultural environment as much as in the regulatory environment.

Entrepreneur Skills: Management skills and entrepreneur culture is essential to grasp the benefit of private equity and is identified by equity firms as a priority for the development of the private equity sector. Governments need to link investments in human capital to the management skills needed in this market**.** The availability of private equity may help foster a culture of entrepreneurship in the GCC region.

Overcoming the constraints outlined above will undoubtedly increase the confidence of private equity firms to partner with local businesses. Qatar and the GCC, due to their economic outlook and government finance, are much better equipped than some other emerging markets to capture the untapped potential and benefits from what the market offers in terms of supporting their diversification policies and strengthening the private sector. A sign of this confidence in the market is the launching by Sarasin-Alpen and Partners Limited (an asset management company owned jointly by Bank Sarasin-Alpen and Sarasin & Partners LLP London) of Sarasin GCC Equity Fund to invest in the GCC equity markets. Commenting on the decision, the CEO of Bank Sarasin-Alpen said, "The GCC is a region full of opportunities and it is with this in mind that we chose to launch the Sarasin GCC Equity Opportunities Fund" (AME info: 2007). The bank has an established investment process, developed not just to cope with, but to prosper from, the unique characteristics of the region; it allows exposure to be increased when the market is trending upwards and reduced when it is trending downwards. It is a process well-suited to clients who are aware of opportunities as well as risks, and well-suited to the current climate where more assurance is needed in the market. There is now growing competition among Global private equity operators to invest in the GCC region, including blue-chip private equity names which should boost the region's efforts to diversify its economies. According to Stuart Pearce, CEO and Director General of the Qatar Financial Centre Authority, "There's no slowdown in sight, private equity funds raised in the GCC are set to grow at around 25 percent a year for the next three years" (Watts: 2007). While the real estate and construction sectors are attracting the lion's share of these investments for the time being, opportunities in private sector transportation, financial services, travel and tourism, energy, and other sectors are key areas of interest for these firms, as well as being essential for diversification.

4.7 Conclusion

It is ironic that the financial crisis that is gripping the world came at a time when Qatar and other GCC countries were focusing on developing their financial markets as an essential component of their diversification programmes. Nonetheless, this crisis should be seen as perhaps a reminder of the need to coordinate and cooperate more effectively within the GCC and to focus on the issue of integration of their capital and debt markets. The benefits that such integration would bring is immense in terms of overcoming the constraints imposed on these markets as well as capturing the opportunities associated with the emergence of an effective and well-regulated capital and equity market. More importantly, there is a benefit to be had, from the present opportunity, to learn from the mistakes that caused the collapse of the financial system of the advanced Western economies, and approach the issue of regulation of the system in a more coordinated fashion. Also, the difficult situation that the Western financial markets find themselves in is an opportunity for these emerging markets to consolidate their position globally and gain a bigger share of the market.

The expansion of non-banking financial activities is not only important for financial sector development but also for its linkage to the real economy, especially in terms of expanding private sector investments and generating employment opportunities, both of which are vital for lessening the dependence on oil economy and oil revenues. Nothing demonstrates this linkage better than the present consequences on the real economy of Western countries of the collapse of their financial systems. The need to create employment opportunities for GCC nationals in general in the private sector is imperative to lessen the dependency on state jobs and create a more dynamic job market as well as eliminate the mentality of entitlement that is widespread in the GCC.

Although there are many obstacles to private sector development in the manner that is required for a successful diversification strategy, the potential is huge, especially if issues such as corporate governance and increased knowledge of the business class and tighter regulations and encouragement of small and medium sized companies are pursued by the government of Qatar as well as all GCC countries. Also, in order to achieve its national vision of creating a diversified economy Qatar will need to continue the privatisation programme for its dominant public sector entities. It will be quite a challenge for the government to relinquish control and interest over state enterprises to full private ownership given the size and the diverse activities of these entities. Full privatization is also challenging to the management of these enterprises, creating additional pressure on the issue of accountability and transparency and the creation of an effective corporate governance framework.

Chapter Five

Expansion of the Insurance Sector and Emergence of New Financial Services

5.1 Introduction

As mentioned in the previous chapter, the insurance sector dominated non-banking financial services in Qatar for a long time. However, with the recent development in the equity and debt markets, as well as the emergence of financial services offered by investment and finance companies, the shape and the quality of the Qatari financial system is changing rapidly. Although many of these developments are still nascent and limited in their influence on the economy; nonetheless they are of significance from the point of view of widening the range of financial services and increasing the role of the financial sector in the economy.

In general, the insurance market in the GCC region is recognised as underdeveloped, as it is characterized by the relatively low level of insurance penetration relative to the Western world, or even to Eastern Europe and Latin America. Despite the significant growth of the insurance business worldwide and its coverage of many types of risk from life insurance, health insurance, insurance against accidents of fire, sea and land to non-commercial risks such as insurance against political insecurity that may result in confiscation, nationalization and war etc., the region's share in this expanding business accounts for only 0.25 percent of the world insurance industry (MENA Report: p31) This is even lower than that of Latin America and the Caribbean - whose market is considered extremely underdeveloped - of around 1.5 percent.. Also, most of their business is in the reinsurance of contracts abroad. Local firms benefit through the commission margin on such contracts, as well as other benefits through business operations and activities, but lose out on the lucrative premiums. Characteristically, much of the growth has been driven by compulsory lines of business, primarily in non-life insurance. Even in the United Arab Emirates, the largest insurance market in the Middle East, non-life insurance accounts for most of the insurance business at roughly 85 percent of total premiums, with the focus on motor, marine, engineering, liability and health (*ibid* p32). However, the GCC insurance market has a potential size of USD 20 billion (currently it is only USD 4.5 billion) if the world average of USD 550 per capita is taken as a measure (*ibid*).

The prospects of the sector lie precisely in capturing this huge market and subsequently creating employment opportunities for nationals and in diversifying revenue sources as well as seizing the immense benefits associated with such an increased role of insurance on both the growth side and the investment side of the economy. On the growth side, the industry has the potential to broaden the range of investments, provide expertise in the identification and measurement of risk and to allocate resources to more productive uses as well as to encourage safety by taking measures to reduce the frequency or severity of losses in life and equipment. On the investment side, the long-term nature of liabilities, sizeable reserves and predictable premiums allow insurance providers to serve as institutional investors providing capital for infrastructure and other long-term investments, as well as professional oversight of these investments. However, these benefits are only fully realized if insurance providers invest a substantial proportion of their portfolios domestically. This is why local insurance businesses need to move away from being brokers towards being international insurance companies and take the risks upon themselves in order to reap the benefits, and also expand and improve on local expertise.

As they are aware of these immense benefits to their local economies, GGC countries have made the deepening of the insurance market a priority in their financial sector strategies. Usually, awareness of the role of insurance lags behind that of banking and capital markets, hence raising the visibility of the sector is important, and more importantly the insurance industry needs to improve on its ability to demonstrate the need for and benefits of insurance, especially in non-life insurance. This focus has been helped by the steady, strong growth, since 2004, of the insurance market strong premium growth of around 20 percent on average in non-life insurance. The drivers behind this expansion (in both conventional and Islamic-compliant insurance) has been the rising *per* *capita* GDP and increased stock of insurable assets, fixed assets such as property, vehicles, and infrastructure as well as savings and pension assets. GCC governments are slowly encouraging their nationals to save for their own retirement; life and pension markets are beginning to develop as is compulsory medical insurance. In addition to the support the Qatari government lends to the sector by enhancing its efficiency and sophistication through regulation and supervision as well as risk management, there is increased awareness among businesses and individuals of the benefits of insurance.

The evolution in non-banking activities has extended in recent years to other financial services in the Qatari market, namely, investment and financial companies. They are still limited in numbers and small in terms of assets and investment portfolios, especially in relation to other companies in the GCC region. However, they are making progress and carving out a role for themselves in the domestic and regional markets. The problem for Qatar is that its market of 1.6 million people is made up of unskilled workers who are not in a position to use the services of the financial sector and hence the growth of insurance and the financial sector as a whole will depend on serving the region and other countries. This has been an essential part of the strategy of QFC, according to Stuart Pearce, its CEO and Director General who said, “We can create an insurance industry and a financial system that can service other countries” (Interview, July 2009). The problem is who will be doing the servicing; will it be international players who will use Qatar as a platform, or domestic companies?

This chapter focuses, firstly, on tracing the changes in the insurance business with an emphasis on the prospects and challenges facing the industry together with a discussion of the expansion in Islamic insurance, *takaful* and the challenges it faces. Secondly, it discusses the newly-formed financial investment and finance companies and their prospects. Lastly, it deals with Qatar Investment Authority (QIA). Although QIA is a government-owned entity, its role is exceedingly important since the ability of Qatar’s private sector to invest the surplus revenues of oil and gas is limited, making the government’s role of paramount importance for its economic diversification strategy. In other words, for the foreseeable future diversification will mean diversifying the revenues of the government and partnering the private sector rather than shrinking the role of the government for the benefit of expanding private interests.

5.2 Evolution of the Insurance Market in Qatar

The need for insurance in Qatar was first evident in the mid1950s, due to the growth in the oil economy. That need was serviced by foreign insurance companies either through their agents or through setting up branch offices. However, by the mid 1960s, the first national insurance company, the Qatar Insurance Company, was established on the basis of Law (No1) of 1964. In order to organize and regulate the business, the government issued Ordinance No (1) of 1966 which set limits on the size of capital for both national and foreign companies and the need for foreign companies to obtain permission from the government to operate in Qatar. The Ordinance gave a period of five years for the issuance of licenses for foreign companies. Subsequently, one foreign company was licensed in 1962, two in 1966 and one in 1969, as seen in Table 5.1. An amendment to Ordinance No (1) was issued by Law No (2) of 1971, barring the granting of permission for foreign companies. The intention of the Qatari government was to encourage local capital to invest in this expanding sector and give it the opportunity to develop in a protected market environment.

The demand for insurance services continued to grow as a result of several factors, the most important being: the rise in foreign trade; the rise in domestic investments; the increase in motor-vehicles of all types for a variety of uses; the substantial increase in public spending and the increase in population due to the influx of foreign labour. This continued growth led to the establishment of four more national companies; Qatari General Insurance and Al Khaleej Insurance Company in 1978; Doha Insurance in 1999 and, as a reflection of the expansion in Islamic finance in Qatar, an Islamic Insurance company was established in 1993, the Qatar Islamic Insurance Company as seen from

Table 5.1. The Qatari insurance market is dominated by these national companies, collectively known as the big five and they are all listed on the stock market.

Table 5.1 Insurance Companies Operating in Qatar (QAR 000)

Company	Country of Nationality	Year of Establishment	Capital
National Companies			
Qatar Insurance CO.	Qatar	1964	424,710
Qatar General insurance	Qatar	1978	113,667
Al Khaleej	Qatar	1978	101,640
Qatar Islamic Insurance Co.	Qatar	1993	100,000
Doha Insurance Co.	Qatar	1999	12,724
Foreign Companies			
American Insurance Co.	USA	1963	*5,000
Arabian Insurance Co.	Lebanon	1966	*2,000
Lebanon-Suisse Insurance Co.	Lebanon	1966	*9,855
The National Insurance Co. Of Egypt	Egypt	1969	*2,000

Source: Qatar Statistics Authority, 2006
* Value in year Est.

With the establishment of QFC, these key players are facing a tough environment, since the sector at present functions under two systems - the old system which is more than 40 years old and a new regulatory framework under the auspices of QFC. The two operate in parallel to avoid disrupting the older system, and insurers in both systems are allowed to transact retail business. Under the old system, the insurance sector is regulated by the 1966 law and supervision is undertaken by the Ministry of Business and Trade. The authorities have stopped licensing new insurance companies under this system. As for the new system of insurance business, it is being developed by the QFC to tackle some of the weaknesses present in the insurance market; foremost among these is the regulatory environment. This is not particular to Qatar, but a weakness across the region especially in terms of capital requirements, transparency and corporate governance. A strong regulatory environment is necessary for the development and competiveness of the insurance market. The secretary general of the GCC Chambers of Commerce stressed the need to review insurance rules and regulations in order to keep pace with the global market. He indicated that, “The regulations should be candid and transparent in terms of both principles and applications. They should be able to deal with the basic issue of an insurance company's financial coverage and increase the minimum level of the capital of these companies".

In order to overcome this weakness, in 2006 the regulatory Authority of QFC, implemented a new prudential framework for insurers, including rules relating to the establishment and ongoing review of risk management, minimum capital requirements and,, the measurements of assets and liabilities and actuarial reporting requirements. There is a clear focus by the government on insurance as pointed out by Stuart Pearce, CEO of QFC "We are focusing on insurance because there is a market of USD two trillion worth of projects in the Middle East, and they all need to be insured" (Interview: July 2008). Also, in order to advance insurance services and to attract further insurance expertise, in 2008 the QFC established the Qatar Insurance Platform (QIP) a technology-based insurance trade fulfilment platform. It will provide an electronic trading service, facilitate transaction workflow, deliver trade documentation and effective management information and ultimately enable straight-through processing capabilities to international insurance, reinsurance and brokers who will be able to conduct their trading activities through the platform. As indicated by Pearce, "This is completely unique, that will give Qatar a unique competitive advantage in the insurance market and will help us energise asset management, and with Qatar exchange, the potential to build the capital market is there for us to harness and it's there for us to lose" (*ibid*).

Whether the old elite of the local insurance industry will be able to conform to this new and more competitive environment is difficult to judge but it is in the interest of the government to support the expanding role of the local business under these new tougher circumstances in relation to its policy of diversifying the economy. Local businesses should not be undermined by international competitors but need to develop in such a way as to be able to compete with the more advanced and sophisticated international players and capture a larger share of the local and regional insurance market. There are dangers to local businesses from the two parallel systems and the focus needs to be on the integration of local businesses into the new and better-regulated frame, rather than leaving them to lag behind.

In the face of this new tough competition, insurers are planning to set up their own association which will liaise with the government and other agencies. There is also a proposal to merge three major local insurance companies, namely Qatar Insurance, Doha Insurance and Al Khaleej Insurance. These are good signs that local business is taking on the challenge and enhancing their chances of success. Qatar Insurance Company (QIC) has been a strong advocate of consolidating the insurance companies in Qatar because, as Ali al Fadal, from QIC, indicated, the "Qatari insurance market is small and saturated and local companies are small and it's difficult to compete regionally or globally" (Interview July 2008). He further stated that "The high risk insurance such as oil and gas projects is all reinsured while 100 percent retention applies only to the lower risk insurance such as motoring" (*ibid*). There is a move among insurance companies to expand into medium-risk insurance for one hundred percent retention such as medical insurance. The government's interest in encouraging medical insurance to companies' staff and individuals will help to develop this untapped market.

As a result of the active role of the QFC, major international insurers have shown increased interest in establishing a presence in Qatar. Opening a branch office in Doha has become economically feasible and, for most companies, profitable. While there have been a few foreign insurers and reinsurers in Qatar for many years, they have not grabbed much of the market share. New entrants into the market licensed by the QFC include AXA Insurance Gulf, the fastest growing international insurance company in the Middle East. The company will offer its wide range of corporate products to businesses of all sizes, from large industrial and commercial complexes to small offices and retailers. The range of products includes property, casualty and liability, office, motor, healthcare and marine insurance. The National Manager said, "There are huge growth opportunities for insurance here in Qatar and, as a global leader in risk management, we intend to seize the enormous potential available to us. AXA's leading position in international markets permits us to access an extensive network of expertise and we will use this to deliver to our clients professional service and diversity of products" *(Arabian Business: 2006).*

Fetooh Al-Zayani, the QFC Authority's Managing Director of Business Development Insurance and Reinsurance says:

> The increasing attention being shown in the Middle East markets by such global insurers as AXA, AIG, Alico and Zurich suggests that a paradigm shift is taking place in the region's appetite for insurance. This is driven by developments in the international insurance industry, as well as the increasing maturity of the GCC's economies and the improved business and legal environment being established in these markets (Al-Zayani: 2008).

ALICO – AIG Life was granted licenses between February 2007 and January 2008 to conduct its group insurance operations from the QFC covering wholesale life insurance and retail life insurance in Qatar. ALICO has a long-standing presence in Qatar dating back to 1963 and it is taking the opportunity to expand its operations and strengthen its presence and contribution to the economy of Qatar. This was followed by AIG MEMSA and the Allied Insurance Group who were granted a license to establish a branch and operate from QFC in 2007. The branch offers a full range of corporate and retail insurance in and from Qatar. The increased interest and demand for insurance, especially Islamic insurance, has been the driving force behind the flow of these international firms.

The QFC is trying to overcome another of the industry's weaknesses, namely its lack of visibility. This is being improved by the emphasis on the development of the sector though the work of QFC and the raising of awareness of the social and economic benefits of life and non-life insurance, individual and corporate. Aware of the massive prospects of the insurance market, the QFC Authority hosted an international business event, in March 2008, for top representatives of major international insurance and reinsurance and brokerage firms who are already licensed by the QFC or looking at business prospects in Qatar and the region. The event was an opportunity for representatives of Qatar's and the region's business and financial community to come into contact with their more powerful international competitors, and provided high visibility for the sector locally, regionally and internationally.

Nonetheless, the question remains as to whether the insurance business, conducted under this more stringent regime, will compete with local insurers, especially as existing local companies are hesitant about switching operations to the QFC because of the tougher regulatory requirements that they would have to meet. This competition might push local companies to enhance their operations and become more competitive as indicated by their attempt to create mergers. On the other hand it might make it tough to operate successfully and be able to compete with well-established international players in the field. This might appear as contradicting the government's focus on diversification and on expanding the private sector. Subsequently, the encroachment of international players on local businesses must be approached carefully; there is still a need to protect local businesses that lack the expertise, the skills, and the know-how to grab the opportunities that are available in this expanding regional market.

One must acknowledge that the Qatari government, by developing this new system, is addressing some of the obstacles and inadequacies of the insurance industry, which have been of concern to the financial community both regionally and internationally. In his opening address to the International Arab Banking summit in Brussels in 2007, the Governor of the Bank of Belgium pointed to some reforms that were needed in order to stimulate financial sector development in the region. These were primarily the deepening of financial markets through strengthening the regulation and supervision of securities markets, broadening the investor base and improving transparency, allowing greater autonomy to supervisory agencies and providing them with more resources to hire, train and retain qualified staff and bring financial institutions into line with international best practice by establishing commercial courts, strengthening corporate governance and fostering a sound credit culture (BIS Review: 2007). By putting in place an appropriate regulatory framework, the government gives the sector stability and growth as well as making it more suited to benefiting from the massive investments anticipated in the GCC region. The size, complexity and technology of these projects is associated with soaring risk exposure - personal, physical, financial and political- and is creating a need to augment a culture of risk management throughout all businesses in the region. Of the USD 1.6 trillion worth of projects, Qatar's share exceeds USD 140 billion (Al-Zayani: 2008).

However, there are very important gaps in dealing with corporate risk issues and risk management skills and training and these must be overcome in order to attract insurers. Lord Levene, Chairman of Lloyd's, in a speech on 28 June 2007 at the Second Annual City and Gulf Cooperation Council, addressing business leaders about the new global risks that threaten corporations stated:

> Insurers, to take on the growing exposures of present day environment, want to work with companies who are willing to develop risk management culture and implement risk management processes at every level of the organisation to understand and mitigate them..Risk management must be at the heart of business strategy, especially in the Middle East where risk exposures are soaring...Gulf states now have a growing need –and an unprecedented opportunity – to build an insurance sector which supports this growth , and interfaces efficiently with the wider global market. (LIoyds: 2007).

The expertise of international insurers is of paramount importance to local and regional companies, but there needs to be a basis of cooperation at this nascent stage of the development of the insurance industry, so that both sides can reap the benefits of this growing market. The objective of opening up Qatar to international firms is to enhance the competitive spirit and raise the standards practised by all insurance players in the market and bring new expertise and talent into the region. That experience, nonetheless, can only be beneficial to local businesses if there is partnership between local businesses and international players. Otherwise they represent a challenge and a threat for the expansion of a regional pool of highly-qualified and experienced people in the insurance sector.

5.3 Growth and Challenges of the Insurance Industry

Although the insurance industry in Qatar, as the data presented in this section will show, has been growing rapidly and is profitable, Qatar shares particular characteristics with the rest of the GCC insurance market that are hindering the growth of the industry and its contribution to the economy. These can be summarised as low market penetration levels, fragmentation of insurance market and dominance of reinsurance. The government needs to focus on these obstacles in order to enhance the chances of local businesses to grasp the benefits of this expanding industry and compete with the international players. These obstacles will be discussed separately as follows:

5.3.1 Low Insurance Penetration level

This is one of the major challenges facing the development of Qatar's insurance industry. The insurance market of the GCC region represents a very small portion of the global business. As seen from Table 5.2, the insurance business in the region (UAE, Saudi Arabia, Kuwait, Qatar and Oman) accounts for less than one percent of world premiums with low penetration levels (premiums/GDP) of 1.44 percent compared to the international ratio of 7.5 percent. Despite these very low shares, the market has witnessed high levels of growth in the past few years, around 20 percent for the region and 25 percent for Qatar, thus making the potential for insurance value enormous.

Table 5.2 Qatar's Comparative Market Share of the Insurance Industry

Country	Total premium volume USD 2006 (mn)	Life premiums USD (mn)	Non-Life premiums USD (mn)	Insurance penetration (%GDP) 2006
UAE	2,726	418	2,308	1.7
Saudi Arabia	1,590	19	1,571	0.5
Lebanon	656	209	447	3
Kuwait	628	113	515	0.7
Qatar	573	26	548	1.1
Jordan	347	36	311	2.4
Oman	349	37	312	1.1
World	3,723,412	2,209,317	1,514,094	7.5
- as % World	0.20	0	0.4	1.44

Source: Moody's Global Insurance - February 2008

This rapid expansion in Qatar was driven by the spectacular growth of the economy coupled with an increased awareness of the necessity and benefits of insurance services. This had an impact on the insurance companies' growth in activities across the different types of insurance that are prevalent in Qatar. Over the period 1978-2005, insurance activities expanded substantially and that is reflected in the rise in the total value of premiums realised by the insurance companies. These increased from a total of QAR 204 million in 1985 to QAR 2.5 billion in 2006, more than seventeen-fold, as seen in Table 5.3. It is also noticeable from the table that national companies dominate the business with an average share of 93.3 percent. This is helped by the decision of the government, whereby all government agencies are obliged to handle their insurance requirements only through national insurance companies. The opening up of opportunities to international insurance companies to take a bigger role in the region through Qatar Financial Centre will undoubtedly have an impact on the potential growth of local business and its ability to compete.

Table 5.3 Total Premiums Collected by Insurance Companies (QAR mn)

	1985		1990		1995		2000		2005		2006	
Items	**QAR**	**%**	**QAR**	**%**	**QAR**	**%**	**QAR**	**%**	**QAR**	**%**	**QAR**	**%**
Vehicle Insurance	53	26	80	27	177	33	151	36	345	22	554	22
Marine Insurance	53	26	157	52	135	25	99	23	228	15	280	11
Fire Insurance	18	9	43	14	129	24	85	20	151	10	216	9
Accident Insurance	79	39	24	8	97	18	87	21	813	53	1,415	57
Total	**204**	**100**	**304**	**100**	**538**	**100**	**422**	**100**	**1,537**	**100**	**2,466**	**100**
National Companies	179	88	280	92	506	94	383	91	1,482	96	2,358	96
Foreign Companies	25	12	24	8	32	6	39	9	55	4	108	4

Source: Ministry of Business and Trade, 07

Most of insurance companies' business, up until 2000, came from motor-vehicles and marine insurance. The steady increase in the share of marine insurance reflects the political instability of the region which forced national insurance companies to reinsure abroad to lessen the burden of growing risks. In this respect, Qatar follows many developing countries, where risky and voluminous insurance is reinsured abroad, thus rendering local insurance companies as mere brokers. On average, local companies in Qatar reinsure 62 percent of their total premiums abroad, which is an indication of the large volume of business involved in high-risk insurance policies**.** Accident insurance has seen a steady rise since 2000 surpassing both marine and vehicle insurance to account for more than 57 percent of the business by 2006.

The relative share of claims paid to total premiums collected during the period 1978-2006 stood between a low of 39.6 percent in 2006 and a high of 79.7 percent in 1999, while the average for the period did not exceed 58 percent, as seen in Table 5.4. This is evidence of the profitability of the business and how well companies have performed. In addition to the gross profit, local companies achieve a fairly good margin of commission on reinsurance, as well as benefits from business operations and activities, thus making their final profit figure much higher. Despite the growth of the insurance business, the product range is limited, with more than half of non-life insurance going to property and miscellaneous accident cover and motor insurance. Motor insurance is increasingly becoming challenging to insurers. The government has capped the compulsory third party vehicle liability tariff since 1994. The levels were set at rates ranging between QAR 250 (USD 69) and QAR 500 (USD 138). Subsequently, a committee under the Qatar Chamber of Commerce and Industry was formed to lobby the government to increase motor premiums that have not been revised for years despite the increase in prices of automobiles and spare parts and the overall surge in the cost of living. Claims to premiums

Ratios are high and insurers are facing rising losses; car accidents in Qatar have soared in recent years. The government, nonetheless, is aware that at present, raising the cap would undoubtedly affect the lower-earning segments of society at a time of rising living costs. The public transport system needs to attract more passengers before it is able to increase fares. In the meantime, some insurers are selling retail motor insurance as a loss leader to serve as a starting point to sell other more profitable lines.

The share of insurance premiums of total savings, which provides an important indicator of the development of the insurance market and its possible positive impact on private sector growth, is still low. It is noticeable across the GCC that insurance premiums account for a very low share of the savings, although the GCC has a high rate of savings - 47 percent compared with the world average of 22 percent. The share of premiums of these savings is only two percent as compared to 28 percent worldwide (The Review: 2008, p11). This reflects the lack of enthusiasm for insurance, especially life insurance; the share of life insurance for the world is 58 percent while in the GCC it is only 11 percent, while the non-life insurance in the world is 42 percent; in the GCC it is 89

Table 5.4 Net Claims Paid by Local Insurance Companies (QAR 000)

Year	Net Claims*	Net Premiums**	Net Claims To Net Premiums %
1978	35,406	55,830	63.42%
1979	27,731	56,241	49.31%
1980	31,586	72,198	43.75%
1981	45,520	96,996	46.93%
1982	60,571	122,747	49.35%
1983	71,463	113,758	62.82%
1984	52,846	99,779	52.96%
1985	56,278	97,630	57.64%
1986	54,197	97,161	55.78%
1987	52,049	97,528	53.37%
1988	54,625	105,931	51.57%
1989	64,833	106,603	60.82%
1990	85,883	120,612	71.21%
1991	114,827	212,258	54.10%
1992	120,514	189,539	63.58%
1993	136,983	216,454	63.29%
1994	97,136	176,481	55.04%
1995	114,827	212,258	54.10%
1996	N/A	N/A	N/A
1997	136,983	216,454	63.29%
1998	158,261	220,781	71.68%
1999	156,917	196,887	79.70%
2000	136,056	201,939	67.37%
2001	131,355	227,916	57.63%
2002	165,176	274,056	60.27%
2003	189,430	284,224	66.65%
2004	183,297	341,320	53.70%
2005	321,048	546,602	58.74%
2006	363,459	917,768	39.60%
		Average	58 %

* Net Claims represents total claims minus those paid by re-insurance Companies

** Net premium represents total premiums minus re-insurance premiums of re-insurance Companies.

Source: Qatar Central Bank Annual reports, 1978-2006

percent (*ibid*). Cultural and religious factors have been the main reason behind the lack of uptake of life-insurance in the region; however, the expansion of Islamic insurance, *takaful*, is set to change that in the future, as is revealed in the discussion in Section 3.

Although Qatar and the other GCC countries are rich in capital, insurance premiums can act as a stimulus to the private sector and can support its expansion - a much-desired objective in these economies, in order to reduce the disproportionate share of the public sector due to the dominance of the hydrocarbon industry.

However, unlike Western insurance companies that have the advantage of being able to invest their funds in a wide and liquid pool of assets ranging from cash to bank deposits, fixed income securities (corporate and government issued), equities, real estate and alternative assets, Qatari companies' asset selection is challenging. This is due not only to the current climate, but to limited asset diversification on the domestic capital market, the small number of securities listed on the domestic stock market, and low levels of local currency denominated fixed income securities. This explains the large portions of invested assets in bank deposits while the volatility of the stock market represents a credit challenge to many insurers. The continued growth in capital markets and the *Shariah*-compliant capital market should lead to wider asset choice and reduced asset volatility over time, with increased asset-matching skills.

5.3.2 Insurance Market Fragmentation

Another major challenge for the insurance market in Qatar, which is typical of the GCC market in general, is market fragmentation. In 2007 there were 57 companies serving a population of 34.8 million people, collecting a premium of USD 2.9 billion. In comparison, India had 28 companies serving a population of 1.2 billion collecting a premium of USD 17.3 billion - quite a staggering difference. The very small market in Qatar is shared between nine companies with a high concentration in the top five local groups who have a market share of 84 percent: In 2006 Qatar Insurance Company wrote gross premiums of USD 196 million: Qatar General Insurance Company USD 96 million; Al-Khaleej Insurance Company USD 42 million, Doha Insurance Company USD 35 million and the Qatar Islamic insurance USD 29.7 million. Even these top five are quite small and that is a reason why mergers are the way forward and not only mergers inside Qatar but also mergers within the GCC countries. These mergers are challenging because most of the companies are family-owned and run and investors' experience is modest and has not matured enough to capture all the potential benefits of the insurance market.

The financial position of these national insurance companies is strong, which is reflected by their balance sheets, but if they are to capture any of the benefits of the pipeline of projects earmarked for the region, there is a need for a restructuring of the companies through mergers and through increasing the pool of skills and knowledge. The data in Table 5.5 indicates a substantial increase in their total assets, growing over the period 1980-2008 nearly fortyfold, from a total of QAR 177m to around QAR 9.9bn. The increase of assets is mostly attributed to a substantial growth in investments from a mere QAR two million in 1980, peaking to around QAR 5.7 billion in 2007 and then dropping slightly to QAR 5.4bn in 2008. Recent investment portfolios show that insurance companies took advantage of the building boom during the period 2004-2006, and doubled their real estate investments. One particular area that has seen increased penetration is property insurance, due to the property boom that Qatar is experiencing, that has pushed up demand for all types of property insurance. Developments in the field of health insurance, in light of the prospect of a new legislation making health insurance compulsory for construction workers to cover accident liabilities, is another potential area of growth.

Table 5.5 Consolidated Balance Sheet of National Insurance Companies (QAR mn)

Items	1980	1985	1990	1995	2000	2004	2005	2006	2007	2008
Cash and deposit balances	112	212	207	222	257	490	905	978	1,627	1,930

Other receivables	39	98	99	197	215	252	326	1,001	1,541	1,727
Reinsurance Contracts	13	28	54	56	89	412	619	334	514	576
Investments	2	71	214	479	522	2,616	5,158	4,564	5,672	5,436
Other assets	10	38	49	52	157	121	169	80	190	212
Assets=Liabilities	177	447	623	1,006	1,240	3,890	7,176	6,957	9,543	9,879
Borrowing from banks	16	47	45	87	83	37	135	189	521	723
Insurance contracts	12	29	57	96	81	669	949	948	1,995	2,498
Provisions	32	61	84	164	166	325	403	744	939	1,301
Shareholder's equity	113	290	405	584	850	2,791	5,532	4,543	5,810	4,970
Other Liabilities	4	20	32	75	60	67	158	533	278	386

Source: Qatar Central Bank Annual Reports, 1980-2008

It is evident from the data that shareholders' equity is the main source of funds which finance their activities, representing on average 65 percent of total liabilities for the period 1980-2008. It is typical for insurance companies in the GCC region to have a high percentage of equities in their investment portfolios. Improved capital and risk management requires further development, especially in terms of the quantification of these risks, in order to ensure earnings over time. Many insurers rely on strong links with the ruling family, including board membership, such that some companies could have some expectation of support from the government.

Despite the many challenges and weak structure of the insurance industry, local insurance companies are presented with an unprecedented opportunity in the GCC to capture an expanding market and to develop a common market for insurance in the region through consolidation and a common regulatory frame, which will lead to better opportunities and greater potential for growth. Another advantage the GCC can utilise is the fact that 60 percent of listed insurance companies in the Arab region are listed in the GCC, which only accounts for around 13 percent of the total population of the Arab region. It could become a centre which would serve the whole region. Another untapped source of growth for the sector is the expatriate community. In mid 2008, Dubai Islamic Insurance and Re-Insurance Company (Aman) agreed to allow expatriates to own around a 15 percent share of the company's shares, leading to an increase of shares and benefits to the market. Managing Director of Aman, Hussein Mohammad Al-Meeza said, "This decision will have a positive impact. It will bring diversification and inject capital investment in the market. This is simply due to the fact that there are so many UAE residents that are willing to invest locally. We, at Aman, are giving them the opportunity to invest and bring shared benefits to the parties involve" (UAE Interact: 2008). Qatar and other GCC countries can follow suit and exploit this large dormant market.

5.3.3 Growth of the Reinsurance Market

Reinsurance is a way of transferring or ceding some of the financial risks one insurance company assumes to another insurance company. Primary insurers and reinsurers can share both the premiums and losses or reinsurers may assume the primary company's losses above a certain limit in return for a fee. Qatar's insurance market, like its counterparts in the GCC region, is over-reliant on reinsurance. This over-reliance usually suggests limited capitalization/risk-bearing capacity or over-reliance on reinsurance technical assistance, neither of which are regarded as credit positives, and both of which represent a challenge for the development of the insurance industry. The average ratio of reinsurance in the region is 52 percent of all instalments, which is higher than the rate in the current international market. A more staggering figure is that 95 percent of reinsurance business in the GCC region goes to international companies outside the region. There is a need for a large reinsurance company in the region to stop the flow of capital to foreign companies.

A step in this direction has been taken by the GCC countries through Gulf Investment Corporation (GIC). The corporation was established in 1983 and is equally owned by the GCC member states. A joint venture between GIC and Arch Capital Group established Gulf Re in May 2008 in Dubai International Financial Centre. Gulf Re's initial capital was USD 200 million with an additional USD 200 million to be funded depending on the business needs (GIC: 2008). Arch capital is a global company, with a capital of over USD 4 billion, providing insurance and reinsurance through its wholly-owned subsidiaries. Gulf Re will focus on reinsurance of high-value oil, gas, power and water desalination projects in the six member states. The reinsurance business of these projects accounts for USD 1.8 billion of which 95 percent goes to international companies. Gulf Re is targeting a considerable portion of this business, around USD 1.3 billion (*ibid*).

Arch capital has substantial experience in assessing and managing risk and will focus on risk management and on assisting clients in understanding risks and ways of managing them. The specialist expertise of Arch Capital will also be beneficial in addressing the shortage of insurance and reinsurance specialists in the region, offering its training programmes to clients and to insurance companies. According to the CEO of GIC, Hisham Al-Razzuqi:

> Gulf Re will meet the need for a Gulf-based reinsurer with significant financial resources and specialist expertise...The company will add depth to the GCC insurance sector and support the growth of GCC insurers. Gulf Re will benefit from the technical expertise and support of Arch Capital...This is a strategic long-term investment for GIC, in line with our mission to develop financial services in the GCC (*ibid*).

Qatar and the GCC region in general are set to experience a massive surge in demand for reinsurance products over the coming years. The dramatic increase in investments and subsequent asset creation is providing a huge potential for reinsurance. This type of joint venture is a good example of how to build local expertise and how to join forces with internationally-recognised and renowned insurers to create local capacity for reinsurance that can meet the demand of the expected high volume of business. Considering that 95 percent of reinsurance business in the GCC region currently goes to international companies outside the region, the necessity to retain a portion of that business in the region becomes apparent (Zawya: 2008, January 14).

5.4 Growth of the *Takaful* Market

As mentioned earlier, one significant development that will help overcome the lack of demand for insurance in the region, especially in life insurance and personal lines insurance, is the expansion of Islamic insurance, *takaful*. The world's first *takaful* company, the Sudanese Islamic Insurance Company was established in 1979. Since then, there has been an explosion in the growth of *takaful* operators, with a number of major insurers entering the market, including Allianz, AIG, Munich Re and Hannover Re.

Takaful is not a new concept; the idea of a cooperative risk sharing is the oldest form of insurance. However, the Grand Council of Islamic Scholars only approved *takaful* as a *Shariah*-acceptable alternative to conventional insurance in 1985, basing it on the principle of mutuality with emphasis on co-operation, inter-responsibility and assistance between groups of participants. The following is a detailed analysis of this market.

5.4.1 The Current Position of *Takaful*

At present *takaful* makes up a small part of the Qatari insurance market with three active companies (Qatar Islamic Insurance, Al-Khaleej Insurance operating one *takaful* branch under the name Qatar Takaful and Doha Insurance subsidiary Doha Solidarity) accounting for 17 percent of the total insurance. As noted by QNB, General Manager, Mr. Ali Shareef Al-Emadi "The growth of Islamic banking have had an effect on stimulating the Qatari *takaful* market from customers needing insurance in connection with bank loans that have to be insured the *Shariah*-compliant way" (Interview, July 2008).

The premium growth of the *takaful* market has been staggering with some players reporting growth of fifty percent or more over the last few years. The opportunity is substantial enough to reach that large segment of the population that conventional insurance is not attracting, by providing religiously-acceptable *takaful* for non-life insurance and family *takaful* for life insurance, see box 5.1.

BOX 5.1: DEFINITIONS OF ISLAMIC INSURANCE

Insurance v *Takaful*: *Takaful* is the Islamic alternative to conventional insurance products. It is based on the principle of mutuality with an emphasis (particularly for life) on co-operation, inter-responsibility and assistance between groups of participants. In essence the economic structure of a *Takaful* company can be seen as a hybrid between that of mutual insurers and conventional insurers.

Life Insurance v Family Takaful: While life insurance was seen to be problematic initially, scholars looked at Islamic principles of mutual insurance and providing a social safety net. This eventually matured into the concept of family Takaful, which provided insurance for the loss f family members.

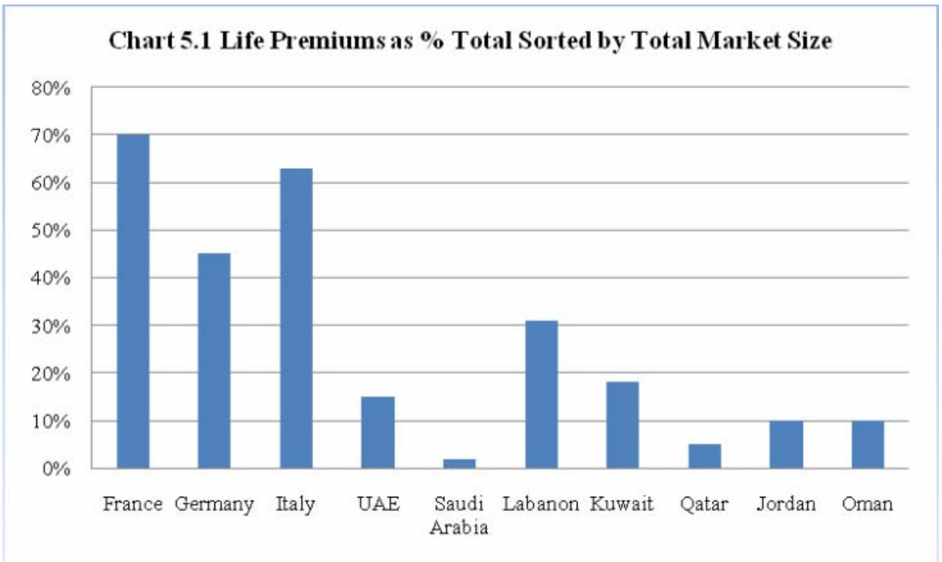
Reinsurance v *Retakaful*: Just as a primary Islamic insurer can accept primary business from both an Islamic and a conventional customer, a *Retakaful* company can reinsure both an Islamic and a conventional insurer. The main difference lies in the management of its investment portfolio: a *Retakaful* insurer must ensure that it makes only *Shariah*-compliant investments.

Source: EFG-Hermes, GCC Insurance Primer, October 2007.

Cultural and religious factors played a role in the underdevelopment of the insurance market in the GCC region, especially life insurance. As seen from Chart 5.1, the share of life premiums in Qatar is around five percent of the total insurance market. Even in the

UAE – the biggest insurance market in the GCC - the share is around 15 percent compared to 70 percent in France. *Takaful* could be a key to increasing insurance awareness and to overcoming these cultural and religious obstacles.

The GCC is emerging as the heart of the global *takaful* market, with accepted contributions in excess of USD 1 billion as compared to global contributions of USD 2 billion in 2006. Of the world total of 133 *takaful* operators, 59 are within the GCC (EFG-Hermes: 2007). It is forecasted that the global *takaful* business will rise from the 2006 level of USD two billion to USD 7.4 billion by 2015 (Moody's: 2006).



Source: Moody's Global Insurance - February 2008

The market is growing at a rate of 40 percent, and this growth is spurred not only by personal lines but also by commercial lines. According to Sameer Abdi, head of Ernest and Young Islamic Finance Services Group:

> Assets held and financed by the Islamic financial services industry are increasingly motivated to use *Takaful* to underwrite risk. Existing *Takaful* capacity is slowly replacing conventional insurance in the industry. The challenge for *Takaful* operators lies not only in tapping demand but also in developing their capacity and expertise to provide a competitive alternative to conventional insurance (Ernest & Young: 2008, p44).

At the recent World *Takaful* Conference held in Dubai in April 2009, it was reported that by 2012 total *takaful* contributions could reach USD 7.7billion per year (*ibid*)). Even higher projected growth had previously been reported. HSBC, for example, estimated that the global *takaful* market would be worth USD 14.4billion by 2010. This growth is spectacular when one considers that *takaful* contributions (premiums) were reported as being USD 1.4million per year in 2004 rising to an estimated USD 3.4billion in 2007, the majority of those contributions coming from within the GCC with South East Asia following behind (Opcit, p13). One must keep in mind that global *takaful* contributions are less than one percent of the total insurance premium spent annually, despite the fact that Muslims represent a quarter of the total global population; there are around 1.5 billion Muslims around the world being underserved by the insurance sector (Swiss Re Sigma Report: 2008, p 4).

This is a huge market, even if it remains to be determined what proportion of this population is accessible to insurers. The fact is in key markets, such as the Arab region, insurance penetration remains very low, and the potential to attract new insurers is massive. In addition, *takaful* can be also attractive to those who are concerned with all forms of ethical finance or attracted by the possibility of a return of surplus generated on the contribution they provide in order to receive insurance protection.

Naturally, the global financial crisis had an impact on this nascent industry, and it has seen an erosion of profit margins as a consequence of its dependence on equities and real estate and the shortage of long-term liquid investments. Growth forecasts in global markets worldwide have been affected, and major *takaful* markets are no exception. "Figures published by Ernst & Young in their latest report suggest that in taking a sample of GCC and Malaysian *takaful* operators, the average return on equity in terms of percentage has dipped significantly in 2008 (especially in respect of GCC companies) and is expected to rebound during the course of 2009" (Ernest & Young : 2008, p26). However those *takaful* operators that are able to successfully manage their business during this challenging economic environment will be well placed to take advantage of opportunities that arise when markets begin to pick up. Also, *takaful* may be perceived as being more attractive to consumers as it offers a more conservative method of running a risk carrying entity especially after the current global financial crisis undermined investors' confidence in conventional investment products.

Accompanying the growth of *takaful* has been an expansion in the re-*takaful* market. A re-*takaful* can reinsure both an Islamic and a conventional insurer but only in *Shariah*-compliant investments. Dubai is the first GCC country to take advantage of this market by joining hands with Malaysia to create the largest re-*takaful* firm, Dubai Banking Group and Khazanah National and Asian Capital Reinsurance created ACR Re-Takaful Holdings in mid 2008. Similar reasons exist for the large potential of growth of the re-*takaful* industry in the region as with *takaful:* the low rate of Islamic insurance market penetration, the ongoing infrastructural and trade activities in the Gulf combined with the growth of the *sukuk* market which could be a key supporting factor in the growth of re-*takaful*.

5.4.2 Challenges Facing the *Takaful* Industry

The appropriate tapping into of the *takaful* market depends on addressing a number of critical factors and challenges. The market needs to demonstrate similar, if not better, service quality than the conventional sector to persuade the uninsured market to use the facilities of *takaful* and increase awareness of the need for and benefit of insurance, especially in markets where cultural and religious barriers have obstructed the growth of this market. Also, because the essence of *takaful* is cooperative risk and community well-being rather than the optimization of profit, it is imperative that policy holders' funds are managed properly with improved transparency and corporate governance. The following discussion delves into the specific factors that need addressing by providers of *takaful* and by concerned governments. The World *Takaful* report of 2009 included a full discussion of the obstacles confronting this nascent industry. The following is a summary of the most significant ones; they include availability of *Shariah*-compliant investments, authentic and accurate *Shariah* compliance, demographic considerations and distribution channels.

***Shariah-Compliant Investments*:** Finding suitable assets to invest the revenues generated by contributions is a key challenge to *takaful* operators. This lack of diversification in investments limits the flexibility afforded to them to manage their investments as efficiently as possible. Since the recent economic crisis, this challenge has intensified in its scope. Development of suitable products is essential to move away from the apparent dependency on real estate and equity markets, which in the current climate have exposed these investments and undermined the credibility of the market.

Shariah Compliance: Another important factor to maintain credibility is the necessity for the *takaful* industry to ensure that the mechanisms by which *takaful* works are *Shariah* compliant. Investor confidence in an area driven by ethical considerations inevitably plays a big part in choosing this market over the conventional market or in persuading Muslims to even enter the market of insurance at all. One example of this is in respect of the doctrine of *tabarru* (donation) which governs the payment and receipt of contributions by participants to the *takaful* operator. The legal status of these contributions has not been determined. The doctrine of *tabarru* is traditionally considered to make *takaful* contracts a form of a unilateral contract with the *takaful* operator However in practice many contracts issued by *takaful* operators appear substantially similar to those provided by their conventional counterparts and take the form of a bilateral contract.

Another example concerns the distribution of surplus to participants. This return of surplus is a cornerstone of *takaful* and is essential in order to avoid traditional Islamic criticism of conventional insurance. However, by retaining funds *takaful* operators are exposing themselves to questions as to what the difference is between the *takaful* model and conventional insurance. The use of conventional policy wordings by *takaful* operators has also led to questions about the *Shariah* compliance of certain products. It is possible for *takaful* operators to use conventional wordings as a useful template or starting point from which to develop *takaful* wordings, but it is imperative that they arrive at their own *Shariah*-compliant wordings.

Distribution Channels: *There* is a need to develop distribution channels, particularly if the *takaful* industry is to succeed in penetrating personal lines such as family *takaful*. Bancassurance, which simply means an amalgamation of insurance and banking business through the selling of insurance products via a bank's established distribution channels, is widely recognised as an important platform from which *takaful* operators can reach out to potential consumers through their chosen banking provider. Also this synergy between banks and insurance is beneficial for both; bancassurance has the potential to contribute a high share to banks' fee-based income.

Speaking at the first Middle East conference on Bancassurance, George Oommen, Executive Director of Insurance and Reinsurance at Dubai International Financial Centre, indicated that, "There is huge growth potential for insurance in the region. Years of misunderstanding and misconception have created mental blocks against insurance in Muslim cultures. *Takaful* is the way forward. However, distribution holds the key. With Bancassurance gaining ground, there is huge potential for growth in the region" (Gulf News: 2007). "However, regulatory hurdles and a lack of the regulation necessary for the protection of consumers and the industry present the major hurdle to the growth of Bancassurance" (*ibid*). In Qatar this huge opportunity of convergence of banking and insurance was seen by Doha Bank in 2002. The bank launched its bancassurance division in 2004, leading to the establishment of 100 percent owned insurance subsidiary, Doha Bank Assurance Company in 2007. This gives the company a competitive edge and the possibility of capturing some of the benefits associated with this market.

Shariah Scholars: One common theme for the Islamic finance sector as a whole is the need for *Shariah* scholars to assist the growing Islamic finance and *takaful* industry. A current challenge for the *takaful* industry to overcome is to ensure that *Shariah* scholars fully appreciate and comprehend the commercial purpose of products on offer in order to be able to advise in respect of the *Shariah* compliance aspects in a way that both allows *takaful* operators to undertake their business with certainty, and ensures the *Shariah* compliance and credibility of the product. The chronic shortfall of scholars for the Islamic finance industry is compounded in *takaful*, where there are few scholars with any genuine depth of understanding of the insurance market. In addition another persistent problem faced by the Islamic finance industry is the lack of qualified staff and sales people who actually appreciate and understand the product sufficiently to explain it to consumers. These are not easy problems to overcome, and some of them can only be alleviated by accumulating further experience within the market.

Demographic Consideration: Finally, in contrast to the aging populations of the West where the focus may be on providing adequately for retirement, the demographic within Muslim countries, and especially the Arab region, is a youthful population. The challenge will be to ensure that *takaful* products appeal to this new generation and appear relevant to them. Family *takaful* (or the *takaful* equivalent of life insurance) is a particular area in which further growth is expected as it currently remains very underdeveloped. In other words this industry needs to be very sensitive to its target customers with an in-depth understanding of their needs and characteristics. Addressing these challenges is not an easy task and needs to be approached collectively by the key players in the market. GCC governments can play a determining role in supporting and encouraging the resolution of these issues which will be much more beneficial to the growth of industry.

5.5 Investment Companies

Investment companies are an important type of financial intermediary that are either publicly-held corporations or trusts and are in the business of investing, reinvesting, owning, holding or trading in securities. They invest the pooled funds of retail investors into specific investments (in line with the objectives of the investor). They offer individual investors more diversification, liquidity and professional services than would be available to them as individuals. This type of company has been among the largest investors in Western financial markets and they hold a significant portion of outstanding shares of issued stocks, bonds and money market securities.

In Qatar, the establishment and development of investment companies is a very recent trend, although the legal frameeork of organizing, supervising and monitoring this type of business was established by the Qatari government as early as 1979 when it issued Law No (15) of 1979 on organizing the activities of investment companies. The law stipulates the main business domains of investment companies covering investment banking, asset management, structured finance and private equity. The activities of these companies are allowed to follow either a conventional or an Islamic basis.

The expansion of this type of financial service is limited to four national companies: Amwal, established in 1999, the Investment House, established in 2000, the first Investor, established in 2006, and Qatar first investment, established in 2008. The Kuwaiti investment company, The International Investor, a fast-growing company concentrating on *Shariah*-compliant financing and loyalty programmes, opened a branch in Qatar in 2000 as part of its strategy to expand in the region. It is the only regional company operating in Qatar. This market is nascent and its size and scope is still very limited. Among these three, Amwal appears to have made the biggest impact on the Qatari market.

Amwal has had an interesting journey in its development. It started off as the Qatar Ladies Investment Company offering advice to Qatari women on how to save for the future. The driving force behind it was Sheikha Hanadi bint Nasser bin Khaled Al-Thani who was a pioneer in a sector previously dominated by men, encouraging Qatari women to venture into areas outside the traditional accepted domains. This happened after the current E*mir* took formal power and which moved Qatar from a very conservative and secluded era into an open and very ambitious era. Many new opportunities were opened to motivated and determined Qataris with innovative and ambitious ideas. This woman-led company was still novel for Qatar and Sheikha Hanadi describes her start in the business as such, “I remember, in my first meetings everyone looked at me, and thought I was a political statement. But it was more that I was in the right place at the right time and had the right background” (Profile: 2006).

Less than a decade later the firm was rebranded into Amwal which means ”money” and it began carving a leading investment role for itself, serving both men and women, rich as well as the modestly endowed and expatriates as well as Qataris. Amwal was the first investment company to be licensed by the Central Bank of Qatar operating in two lines of business, investment banking and asset management. The firm enjoys a strong shareholder base comprising of Shuua Capital, Qatar foundation, Qatar National Bank, Qatar navigation and prominent individual Qatari shareholders.

Amwal has adopted a very ambitious strategy for its development and growth. It has seen a shift of emphasis in its target customers and operations, away from retail towards targeting institutions, corporations and high net worth individuals. The appointment of a new CEO, Laurent Lavigne du Cadet, was made to facilitate this strategic shift. In his own words:

> I come from the world of investments, and it is not a coincidence that I am here. We want to reorient Amwal. And my mandate is to make Amwal a leading regional investment banking and asset management firm (Qatar Today: 2007, p 62).

There is acknowledgment that the company is small and will not be able to compete with international institutions, but will focus on its biggest asset which is the quality of access to decision-makers in the country and the region and knowledge of the region in order to join hands with larger companies. In that respect, the company has signed several mandates with international banks. Also aware of the big companies, Amwal’s strategy is to focus on fewer products that are sophisticated and specific; they cannot provide 150 products such as Merrill Lynch or JP Morgan but can create a niche market that is differentiated and highly specialized. Accompanying this strategy is a focus on staff; Amwal has one of the largest investment teams in Qatar employing a growing team of professionals. The aim is to have the expertise in Qatar to serve the country and the region as opposed to bringing it in from abroad. It links its growth plans to the huge anticipated projects that are planned in the region that will demand the participation not only of international banks but also investment firms. Among the projects in which the firm has invested is a petrochemicals plant set up by the state-owned Qatar Petroleum. This was the first time that individuals had been able to invest in the petrochemicals and energy sector. The company manages several investment funds among them and, for the first time, one that serves expatriates working in Qatar.

It is branching into heavy investment in the fast-growing real estate market and through providing corporate finance services to clients where the financial advisor to the project owners is acting as the middle party between the project owners and debt lenders/equity investors. Amwal's experience in the real estate market includes being financial advisor to one of Qatar's largest privately-owned estate projects, Al-Waab City. This is worth over USD 2.5 billion and consists of a variety of components: villas, apartments, commercial offices, a five star hotel and a European style piazza (AME Info, 26 June, 2008). It is also bringing to the market new ways of securing exposure to high-return income-generating securities by identifying the growing market for high-return *Shariah*-compliant securities in the real estate sector. The firm has created a family of funds co-sponsored by Shuaa Capital and Kaupthing Bank, most important among them being the *Shariah*-compliant fund to facilitate the Al Waab City project. The CEO of Amwal explains:

> Through this structure, we have also widened the range of financing options we are able to provide to certain professional real estate developers by adding an important element which enables them to bridge efficiently with a larger pool of financing (AME Info, 25 March, 2008)

These new funds will also attract larger institutions and high net value individuals. It is a sign of confidence that opportunities are identified locally in which to invest the surplus, rather than abroad. Another encouraging sign that private investors are being supported is Amwal's involvement in raising the equity for the first Chlorine plant of around 30 percent of the total cost of the project, with an anticipated high return to equity investors of up to 25 percent. Qatar is heavily dependent on imports to fill the growing needs of this important product, in the gas and oil industry. According to the sponsor of the project, Sheikh Mohamed bin Ahmed Al-Thani:

> Qatar Chlorine is an illustrious project in the medium-size hydrocarbon industry further boosting the role of the private sector. It is a promising step which enhances the industrial activity in the country and will attract foreign investment. Qatar Chlorine is poised to promote the private sector's economic participation and to reduce reliance on imports (AME Info, 29 June, 2008)

Amwal is also exploiting the potential in the insurance sector. The firm signed an agreement for mutual cooperation with Doha Insurance Company in order to expand into the niche market of corporate medical and life insurance which is a fast-growing segment in the Qatari market. This agreement will allow them to share expertise and capabilities, improve the efficiency of customer services, set quality standards and after sales services and expand the product range for both international and local coverage.

Following in the strength of Amwal is the Investment House. It is one of the fastest-growing investment companies in the GCC and focuses on a variety of economic sectors: financial services, real estate, construction, manufacturing and services. Together with the Kuwaiti Global Investment House – the largest asset management business in the region by reference to assets under management – it established Mazaya Qatar, a real estate company, in compliance with Islamic *Shariah,* with a capital of QAR 500 million, to take advantage of the boom in the real estate market in Qatar.

5.6 Finance Companies

As Law No (16) of 1979 on organizing the activities of financing companies stipulates, the business of a finance company is restricted to granting loans for different categories of customer, whether individuals, institutions or companies. The activities of these companies are allowed to follow either a conventional or an Islamic basis. Qatar has only one operating financial company; the First Finance Company (FFC), licensed in 2000 by

Qatar Central Bank. First Finance is an Islamic finance company which aims to provide comprehensive Islamic financial services: the provision of all types of consumer finance to individuals, companies and corporates and the expansion of its investment portfolio inside Qatar and in the region.

The company promotes itself as a pioneer in the field of Islamic financial services and has a *Shariah* panel of four Islamic scholars with experience in working on similar panels. They supervise the transactions and services offered by the company and their compliance to *Shariah*. In particular the panel reports annually on: the compatibility of all operations and transactions with the principles and basis of Islamic *Shariah,* the compatibility of the process of profit distribution and loss debiting to investment accounts with the principles adopted by the panel and based on the fundamentals of Islamic *Shariah* law and the calculation of *Zakat* imposed in accordance with the principles of *Shariah* law (First Finance Annual Report: 2002). In addition, the company has a rapporteur and a *Shariah* supervisor to oversee and follow up the implementation of transactions. The *Shariah* panel is also important because it is imperative for the stability of the market to enjoy clearly defined principles and guidelines in a comprehensive framework that provides a level of certainty and choice to investors.

The company is very keen to ensure quality and adopting international standards, and in 2003 acquired ISO 9001:2000 certification, while its credit ratings were raised in 2004 from B+ to BB- in the international credit facilities ratings (First Finance Annual Report: 2004). In accordance with the adoption of *Shariah* principles, the headquarters have a separate section for women to provide them with all finance and privileges that the company offers. The section is staffed by an all-female professional team.

All this is an indication of the ambition and vision of the company. Aware of the immense developments in the financial sector combined with the effects of globalization it perceives the necessity of establishing alliances and mergers capable of providing high-quality specialised services in all fields of finance as well as enhancing the provision of innovative Islamic finance services in order to stimulate economic and social development in Qatar in particular and the Arab Gulf States in general. Some of the regional partners that share similar views and coordinate activities include: First Investment, Investment Dar and Gulf Investment House and Burgan Bank in Kuwait, Dubai Islamic bank, and Arab Banking Corporation Islamic bank of Bahrain.

The company's data reveals its strong financial position: expanding assets, growing shareholders' equity and increasing profits, establishing itself as one of Qatar's big financial institutions. The company started with a capital of QAR 50 million and increased to QAR 353 million in 2007, which is more than a sevenfold increase over a period of seven years (Table 5.6). This indicates strong shareholders' assurance about the prospects of the company. Other financial indicators, such as earnings per share, indicate the huge profits for shareholders since it increased 27 fold from QAR 0.11 to QAR 2.95. Although total revenues suffered a serious dip in 2005, they picked up by 2006 and for the period 2001-2007 revenues increased nine fold.

Table 5.6 Financial Performance Indicators for the First Finance Company 2001-2007

	2001	2002	2003	2004	2005	2006	2007
Revenue (QAR x 1000)	12,193	35,233	60,156	60,777	42,143	69,164	114,114
Total Assets (QAR x 1000)	282,920	419,949	552,157	563,854	724,935	1,205,955	1,690,515
Shareholders' Equity (QAR x 1000)	101,184	111,440	141,172	173,956	206,050	521,131	572,157
Net Profit (QAR x 1000)	1,098	10,499	19,198	22,775	41,887	80,797	103,859
Return on Net Assets (%)	0.39%	2.50%	3.48%	4.04%	5.78%	6.70%	6.14%
Return on Equity (%)	1.09%	9.42%	13.60%	13.09%	20.33%	15.50%	18.15%
Return on Capital (%)	1.10%	10.50%	16.00%	15.77%	25.67%	22.91%	29.45%
Dividend / Shares (x 1000)	-	9,000	14,400	18,772			

Share Capital (x 1000)	100,000	100,000	120,000	144,400	163,172	352,634	352,634
Earnings per Share (QAR)	0.11	1.05	1.43	1.61	2.14	2.58	2.95
Nominal Value per Share (QAR)	10.00	10.00	10.00	10.00	10.00	10.00	10.00
Book Value per Share (QAR)	10.12	11.14	11.76	12.05	12.63	14.78	16.23

Source: First Finance Company Annual Reports , 2005, 2006 & 2007.

The company has achieved an impressive increase of its net profit from a mere one million in 2001 to more than 103 million in 2007 - more than one hundred times increase.

5.7 Qatar Investment Authority

The creation by the Qatari government of a sovereign wealth fund (SWF) in 2005, Qatari Investment Authority (QIA) whose assets are estimated conservatively at USD 60 billion is part of the strategy of economic diversification. With the exception of Saudi Arabia, where wealth has largely moved into the private sector - individuals hold about USD 280 billion to USD 340 billion outside the region - most Gulf wealth is in government hands (Kerr: 2008). QIA's prime objective is to achieve revenue diversification and to minimize risk from Qatar's reliance on energy prices. Investing the massive surpluses of oil and gas revenue in a manner that supports the long-term prospects of the economy of Qatar has become a priority for the government. As indicated by Sheikh Hamad bin Jassim Al-Thani, Chief Executive and Vice Chairman of the QIA, and also Prime Minister and Foreign Minister:

> Our energy sector won't last forever - so we need to secure a good life so they [future generations] can continue the same standard of living…We will have lots more money over the next few years. The challenge is where to invest it (FT, 23 Oct 2007).

Qatar follows in the footsteps of other sovereign wealth funds from Kuwait, Abu Dhabi, Dubai, Singapore and China. Kuwait was the first state to come up with the idea, in the 1970s, of diversifying the economy by investing surplus oil revenues into global asset classes to create a fund to guarantee national income once oil revenues tail off. The Kuwait Investment Authority (KIA) through its future generations' fund takes 10 percent of oil revenues and invests in international and regional firms. In 2006 Kuwait revealed the size of its assets at around USD 213 billion (Kerr: 2007b). Abu Dhabi followed suit quickly and the Abu Dhabi Investment Authority (ADIA) is among the wealthiest sovereign funds in the world with estimated assets between USD 250 billion and USD 875 billion (*ibid*.). Dubai's government owns Istithmar, which makes it a sovereign wealth fund too. However, Istithmar funds investment through real estate sales rather than from oil revenues.

The establishment of QIA is a reflection of Qatar's strategic view of how to shape its economic future as well as its emerging capacity to operate in the global financial markets. Although it is the youngest investment fund in the GCC, it is quickly making a name for itself with some high-profile acquisitions and diversified asset classes. This appetite for acquisitions is motivated by the need to invest its oil wealth to guarantee future economic sustainability. Expressing this need, the Prime Minister and Foreign Minister of Qatar, Sheikh Hamed bin Jasim Al-Thani, stated that:

> If we invest in Treasuries and get four percent or five percent, inflation will eat it...We need high returns. We need to find a way to break through the cycle of the dollar and interest rates. We are taking the lead in investing in new instruments (Wall Street Journal: 2007).

In contrast with other funds in the region the Qatari fund wishes to be principled and do deals directly rather than allocate their capital to the first-rank private equity funds such as Blackstone groups or more specialized ones like Providence Equity Partners. So the authority is making small investments in the funds themselves and asks for huge co-investment opportunities. The following is a detailed analysis of the investment activities of the fund and the challenges it faces.

5.7.1 Investment Portfolio of the Qatar Investment Authority

The strategy of the QIA is to invest its surplus funds in a mixture of asset classes in a variety of places. Since its establishment the Authority has been very active and successful in acquiring assets abroad, especially in Britain. This can be attributed to the historical ties with Britain (up until 1971 Qatar was a British protectorate); the largest European expatriate community in Qatar is British; a disproportionate number of executives were hired from Britain to build the country's financial services and good trade relations. Qatar's asset acquisition in Britain ranged from the Four Seasons, the nursing home operator, to Chelsea Barracks, Harrods department store, London Bridge Quarter and One Hyde Park, London's' most expensive apartment block to its unsuccessful bid for Sainsbury. Qatar is already the biggest shareholder in Sainsbury (25 percent) alongside other big shareholders such as the Sainsbury family and the Iranian property tycoon Robert Tchenguiz.

It is also showing growing interest in the European stock exchange and competing with the United Arab Emirates for the control of shares and access to the technology and infrastructure needed to develop a financial market (Kerr: 2007a). Both states have purchased large stakes in the London Stock Exchange PLC. Qatar purchased a 9.98 percent stake in OMX-AB, the Nordic stock market operator which operates stock exchanges in Sweden, Denmark, Finland, Latvia, Estonia, Lithuania and Iceland. It built up a 23.5 percent holding in the London Stock Exchange (LSE), after buying a further 3.5 percent of NASDAQ's shares to add to its existing 20 percent stake. It was a co-investor in Dubai International Capital's purchase of a 3.12 percent stake in EADS, the European Aeronautic, Defence and Space Company (*ibid*).

Prior to the current global financial crisis, the Authority planned to invest USD 15 billion in global banks in the US and European banks as indicated by Qatar's Prime Minster and Foreign Minister, Sheikh Hamad bin Jassim Al-Thani, after the World Economic Forum Davos. The stake QIA bought in Credit Swisse, of just under two percent with a cost of USD 500 million, is part of this plan (Sender: 2008). However, the drive to invest in international banks has slowed down as a result of the deepening of the banks' crisis and losses. It is estimated that foreign assets held by GCC SWFs fell by around USD 100 billion in 2008 through exposure to foreign assets. (Arabian Business: 2009). The QIA investment of USD 4.52 billion into Barclays, taking a 7.99 percent stake, has lost USD

1.74 billion in value as the bank's shares tumbled. At the start of the crisis, firms in the City and on Wall Street turned to sovereign wealth funds to shore up battered balance sheets and cover subprime losses. Initially, these investors were happy to take the opportunity of gaining holdings in major institutions such as Barclays, Citigroup, Morgan Stanley and UBS. However, with banks in deep trouble and sovereign wealth funds seeing the value of their investments shrinking, the flow of investment has slowed significantly.

The appetite to invest globally, however, has extended beyond Western markets. The authority has invested heavily in Asia especially in real estate projects. It took a stake in the Industrial and Commercial Bank of China at the time of its initial offerings in October 2006 by investing USD 205 million. Executive board member of the QIA, Dr. Hussain Al-Abdulla, commenting on these investments said they "represent a natural extension of our strategy to increasingly focus investments in Asia" (Wall street Journal, Dec 2007). In December 2007 the authority signed a joint venture agreement with the Indonesian government to set up an investment holding company for projects in Indonesia across a broad range of sectors. The Qataris will own 85 percent of the holding company while the other 15 percent will be held by the Indonesian government (*ibid*). QIA will be the first partner in a Singapore consortium led by Keppel Corporation to build the Sino-Singapore Tianjin Eco-city in China. Qatar's interest in investing in sustainable development moves the State into a new focus on green communities. Keppel Seghers – a subsidy of Keppel Corporation is undertaking a project in Qatar to transform the area surrounding Doha North Sewage Treatment Works into an eco-park. Keppel Seghers' CEO indicated that the park will be the first of its kind to adopt remarkable ideas of sustainable development, while the treated water from the Doha North facility will irrigate the eco-park to provide a green space in which the local community can learn, work and play (Gulf Times, 31 January 2008).

QIA recently purchased a 20-25 percent stake in Porsche for seven billion Euros (USD 9.8 billion) with the additional advantage of access to Volkswagen share options held by Porsche which would enable it to control about 20 percent of Volkswagen at a very attractive price. The deal enabled Porsche to get out from under a debt of nine billion Euros that it accrued while attempting to take over Volkswagen in 2008. The authority is also expanding domestically and regionally. In real estate, QIA established Qatari Diar Real Estate Investment Company as a platform from which to handle several significant investments in local as well as regional markets, including Morocco, Egypt, Oman and Syria. QIA also directly owns 100 percent of Qatar National Hotels Company. In private equity, QIA has direct stakes in several Qatari blue chip companies like QTel and co-invests alongside them. QIA's private equity also looks after local private equity and venture capital initiatives such as the Qatar Foundation. This very wide range of places and asset classes will help SWFs such as QIA to withstand the current financial climate, and the losses already endured as a result of loss in investment in the US and Europe, whether in stock markets or banks.

The investment portfolio of QIA will increase substantially in coming years as natural gas contributes more to its revenues. The growth of the economy has been very strong in the past few years with GDP increasing almost tenfold, from USD eight billion in 2000 to USD 80 billion in 2008 and is expected to reach USD 106 billion. Massive wealth needs to be invested for the long-term future of the country, and hence the challenge the country faces is how and where to invest. The Qatari private sector cannot accommodate such a challenge and wealth will continue to be concentrated in the hands of the government and its public sector. In line with its expanded role, the QIA is expanding its staff, adding 40 more members to its current staff of 110 and it will also open overseas offices given its acquisition targets (Kerr: 2007c). Head of strategic and private equity of QIA, Kenneth Shen, said that, “The QIA - while building on its dollar holdings - planned to diversify by focusing investment on several Asian hotspots, such as China” (*ibid*). The authority’s board defines fresh markets and opportunities and then identifies and works with partners in these markets, in contrast to the more established Gulf funds that generally rely on vast internal resources.

Another indication of the economic imperative of investing oil surpluses is the acquisition fund, set up by QIA and the Abu Dhabi government, International Petroleum

Investment Company (IPIC), with each side contributing one billion USD, as an initial investment. An official from IPIC commented that, "We will look at any opportunities where we can make money and add value. That could be anywhere – the Middle East, Asia, Africa, Europe and the United States (*Reuters, 25 March, 2008.* He added, "The fund will be conservative with the first investments and build carefully...You cannot be aggressive from day one" (*ibid*). However, due to the growth of the role and wealth of these Sovereign funds they have drawn heavy criticism from some quarters.

5.7.2 Scrutiny of SWFs

As a result of this growing global influence, intense scrutiny has fallen on these funds and they were the talking point at the World Economic Forum at Davos in January 2008. There are fears that their financial power could turn into political leverage. US Treasury officials held intensive talks during Davos with representatives from these funds pressing them to be more accountable and transparent. The view of the US was expressed by the Undersecretary of the Treasury, David McCormick;

> To date we have seen sovereign wealth funds which have largely been long-term, stable, commercially driven investors…However the growth of these funds and increased levels of their investment does raise legitimate questions about how we can ensure that that investment continues to be commercially driven (Kerr: 2008).

In response, CEO of the National Bank of Kuwait, Ibrahim Dabdoub, emphasised that, "SWF's are not political players, they are financial players" (*ibid*). Other Western countries shared the US stance and called for more rigorous levels of openness and transparency into the activities of these funds, thus provoking protectionist sentiments. This defies Western countries' sacred tenet of free movement of capital and no barriers to investments. The developed world seeks free entry into the markets of the developing world but appears fearful when the developing world want the same in return. The pressure for transparency by critics of wealth funds did not make it clear what precisely that means. Executives of these funds have argued that even large pension funds are not expected to announce their investments in advance and the fact that these funds have made such big investment disclosures would have an impact on markets and put these groups at a disadvantage (Tett: 2008a). Omar bin Sulaiman, Governor of the Dubai International Financial Centre said that "this backlash could encourage regional houses to turn their backs on Western markets and seek more buying opportunities in Asia, where they face little or no such backlash" (Kerr: 2007b). Underpinning all Gulf investment overseas is the need to reinvest oil income in order to diversify their economic base. Also, this new attention on Gulf SWFs and the new scrutiny of the asset classes they are investing in is making Gulf officials resentful of the attention and see themselves "To be victims of crossfire between developed nations such as the US and Germany and emerging sovereign wealth giants China and Russia" (*ibid*).

To steer clear from protectionist policies, the International Monetary Fund has recommended voluntary transparency from sovereign wealth funds in an aim to placate Western fears and to avoid Western states' imposition of compulsory disclosure. A code for SWFs investments is expected to be drafted. Despite these fears, and as a result of the situation in the global capital markets, ,the liquidity crunch on one side of the world and abundant liquidity on the other, international bankers are obliged to court investors in the Gulf in order to find new buyers for their distressed assets. For instance, Citigroup raised USD 7.5 billion in new capital from the Abu Dubai Investment Authority (Tett: 2008b).

Gulf investors are moving away from their traditional approach of quietly investing in stock markets and treasury bonds and becoming bolder and sharper in their approach venturing into commodities market, private equity, real estate and hedge funds, thus increasing the link of their economies to global markets. Dubai Ports paid almost USD four billion for the shipping and ports company P&O in 2006 while Saudi Arabia paid USD 11.6 billion for General Electric's plastic business, the largest foreign acquisitions ever announced by a Gulf Arab investor (*ibid*). The strategic shift in the asset classes and the development of the financial industry of Gulf SWFs is a result of a gradual shift in priorities. Gulf States "Used the liquidity boom firstly in pay down debt, clean up balance sheets and spend on basic infrastructure, now it is about long term investment. The cumulative account balance of the GCC since 2003 is to reach $US 900 billion in 2008"

(Kerr: 2007b). Another important development is the growing sophistication of Gulf investors, who are now happy to deal with complex financial products and are more efficient in the use of their capital.

Sovereign Wealth Funds are expected to be worth USD 17,500 billion in ten years time, jumping from the current estimate of USD 2,500 billion. Global financial assets are expected to double from USD 100,000 billion making sovereign wealth funds share quadruple from 2.5 percent to nine percent. Although that is a doubling of its current share it still represents a small percentage of the global market. So the alarm in some Western quarters is exaggerated. Kito de Boer, McKinsey's Managing Director for the Middle East, suggests that of an oil surplus of around USD 3,000 billion over the period 2005-2020, around half will firstly be invested in the region with approximately USD 750 billion going to investment in the wider Middle East and North Africa, while the rest will go into wealth funds and portfolio investments (*ibid*). Commenting on the effects of the soaring oil prices and the accumulated staggering wealth of Gulf States, he indicated that:

> This is only the second page of the first chapter of the coming of petro-giants. If oil prices remain at a level over $50 a barrel, then this will become a structural shift of global capital flows on a material scale. Naturally the overseas investment levels will depend on the amount Gulf governments commit to domestic economies: they must consider the job creation and other services for their growing population 40 percent of whom are below 15 years old (Kerr: 2008).

Talk in the financial global market is about a shift in economic power; however what is happening is that Gulf wealth funds and Asian wealth funds are increasing their shares in the market in accordance with the size of their assets and taking advantage of global opportunities. In fact, the more these states are linked to the international global market, the more entrenched are their vested interests in the system. This should be a welcome development for the West, rather than the cause for suspicion that surrounds some of the SWFs acquisitions. Until recently, Merrill Lynch investment bank considered the US and Europe as the main areas for the global structured finance world; however, in 2007 the bank started to produce a regular research report on Gulf securitisation issues. In three months November 2007–Feb 2008, Gulf SWFs invested USD 18 billion in Europe and the US (FT, 5 March, 2008). There is no doubt that Gulf SWFs are increasing in size and significance in the global financial market, but that is necessitated by the requirement of capital and its accumulation.

5.8 Conclusion

Qatar insurance sector, as is the case with the overall insurance market in the GCC, is full of prospects and potential for growth as a result of three interrelated elements: steady GDP growth, massive investments earmarked for the coming years as part of economic diversification and active involvement and support of the government of the insurance industry through the work undertaken by QFC. The increased awareness and visibility of the sector and the expansion in *takaful* and re-*takaful* markets will help to capture this fast-growing insurance market on many levels, life and non-life as well as individual and corporate. These changes will increase the sector's contribution to the economy and to employment which remains very limited.

However, whether the infrastructure is available in Qatar or in the GCC region, in terms of human resources, skills and knowledge to capture this potential is uncertain. It is also not clear whether the appropriate legislative and regulatory frame is in place. It could be argued that focusing on bringing international players into the market through the QFC is not the best way to create the necessary local infrastructure to support the development of the financial sector. Mergers, joint ventures and regional cooperation among GCC companies is the best way forward to create regional capacity that can sustain the long-term prospects of the region.

The Islamic insurance market's potential is massive but needs to be underpinned by clear *Shariah* directives and procedures. Another challenge to the policy of diversification is the limited ability of Qatar's private sector to reinvest the liquidity abundance. This means that much of this wealth will remain in government hands and a large part will be invested through the Qatar Investment Fund. Qatar is committed to and focused on encouraging and supporting the expansion of the private sector in order to take full advantage, in the long term, of this abundance of liquidity. However, limited domestic opportunities make a strong case for further cooperation and consolidation among the GCC economies. The fragmented insurance market and the duplications of financial and investment companies across the GCC region will benefit immensely in terms of competitiveness and efficiency from increased mergers and cooperation.

Chapter Six

The Contribution of the Qatari Financial Sector to Economic Diversification

6.1 Introduction

The analysis of the previous chapters focused on each sub-unit of Qatar's financial sector and its development and contribution to the economy. In order to complete the analysis, the focus of this chapter is on the overall role and function of the sector in the economy and its contribution to the government's economic diversification policy. In other words, this chapter will attempt an inclusive assessment of the main objective of the study as to how well-posed the financial sector is to contribute to economic diversification. This will be undertaken in two ways: firstly, by appraising the performance of the sector against three main measures: contribution to economic growth and its share of GDP, employment generation and private sector expansion. The discussion reveals that despite the significant changes and contributions the sector has made towards the economy, and in particular towards economic diversification, it is still limited in its ability and faces many challenges. Aware of these challenges and constraints, the government made the decision in 2005 to create the QFC, as part of its effort to modernise and enhance the capacity and competitiveness of the financial sector as an essential element of its diversification strategy. Secondly, the chapter will delve into the expected role of QFC and its strategy towards achieving the Qatari government's objective.

The QFC has been instituted as an onshore finance free-zone where international financial institutions can set up 100 percent owned businesses and transact with Qatari as well as off-shore entities. This model has been created imitating similar entities created by Dubai and Bahrain. The Qatari government believes that QFC will act as a tool to stimulate finance sector growth in the country and will in turn become an agent of diversification. At present, the financial sector accounts for less than ten percent of the country's total GDP. The Qatari government aims to push QFC to the front of the race for financial prominence among Bahrain, Qatar and Dubai. While Bahrain has an advantage as the earliest starter of the off-shore finance centre model, Dubai has a reputation for a highly-diversified economy. However, Dubai's current financial crisis might dampen enthusiasm for the city and undermine investors' confidence. The QFC is still in its earliest stages and its impact is still limited, nonetheless its strategy and role will have a direct impact on the direction of the development of the sector. As mentioned previously, some of the interviewees representing local businesses expressed reservations towards QFC. It will be very interesting to observe how the government can balance the needs of local businesses with its desire to transform Qatar into a significant financial player.

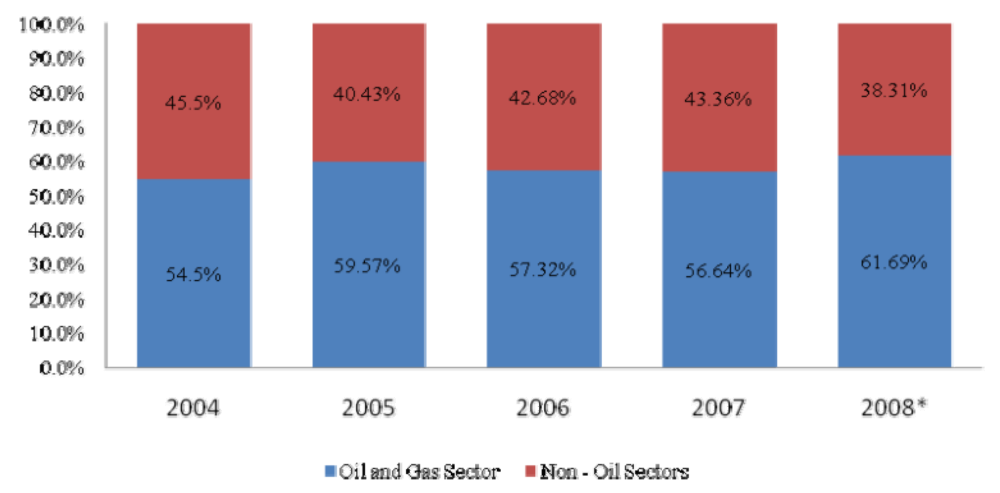
6.2 Assessing the Role of the Qatari Financial Sector

The financial sector contributes to the overall economy in direct and indirect ways. Financial intermediaries are essentially profit-oriented businesses which generate income through value-adding services provided to customers and their profits get accounted for in the national accounts of the country. In addition to this the investments made by these entities get added to the national product. As for the indirect ways in which the financial sector contributes to economic development, these include the generation of employment and the supply of credit to businesses, which in turn add to national product. This section discusses and analyses these important ways in which the financial sector contributes to the economy – contribution to GDP, generation of employment and private sector expansion.

6.2.1 Contribution to Gross Domestic Product

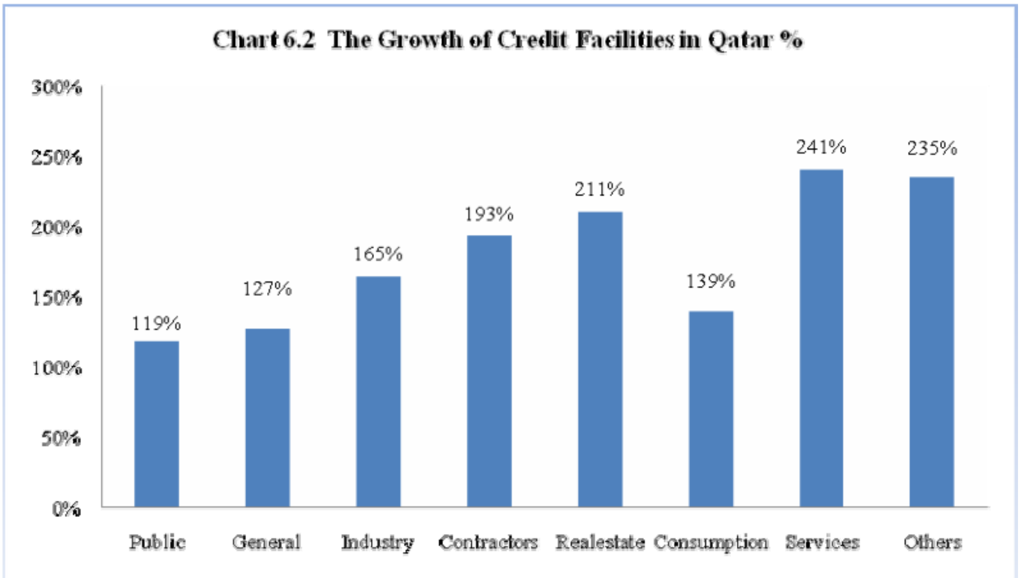
Economic diversification and financial sector development is geared towards moving Qatar's economy away from its heavy dependence on oil and gas and creating a multi-sector economy. The hydrocarbon industry's dominance of the economy can be seen clearly from Chart 6.1. The contribution of the oil and gas sector has been consistently over half of the total GDP during recent years. However, since the deliberate implementation of economic diversification small declines in the relative share of oil and gas sectors and increases in the relative share of other sectors in the economy are observable. The share of other sectors increased to 42.68 percent in 2006 and to 43.36 percent in 2007. Qatar is one of the emerging economies in the region, which include Bahrain and the UAE, which share the same initiative to deploy the resources created through oil income in developing other sectors so that their economies become more diversified and thus "Convert the limited and non-renewable oil and gas resources into sustainable development and prosperity" (Aissaoui: 2009). However in 2008, mostly due to record oil and gas prices, the contribution of the oil and gas sectors increased steeply, to 61.69 percent.

Chart 6.1 Sector Distribution of Gross Domestic Product of Qatar %



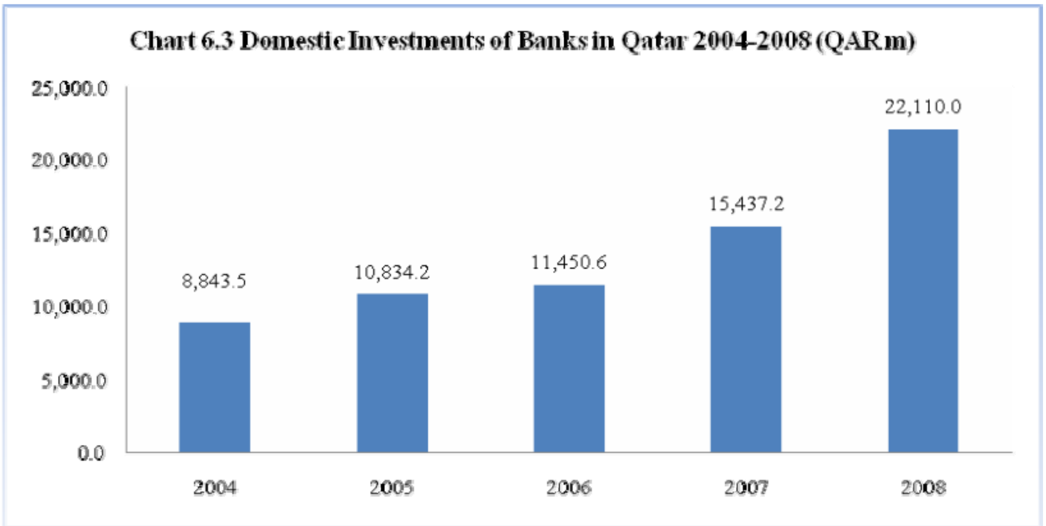
Source: Qatar Central Bank, 2009b

Decreasing the dominance of the oil and gas sector in favour of non-oil sectors is a long-term prospect and one which necessitates a successful partnership with the private sector. Despite this apparent dominance of the hydrocarbon industry in the GDP of the country, Chart 6.2 shows one area where government policy has already had a positive impact. The change in distribution of credit facilities between 2004 and 2008 in favour of the private sector is noticeable from the chart. We can see that the service sector was given a major boost in lending, growing by 241 percent, while contractors and the real estate sector grew by 193 percent and 211 percent respectively. In comparison, the public sector saw the smallest increase in credit during the five-year period of 119 percent. This shows the increased role of banks in supporting private activities as part of the implementation of the diversification policy.



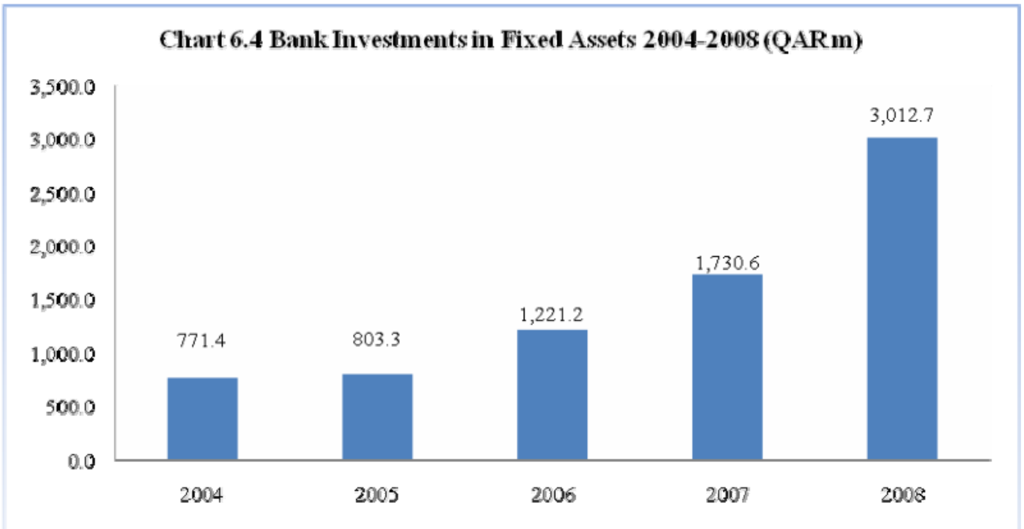
Source: Qatar Central Bank, 2009b

The financial sector has increased its contribution to the economy through investing in domestic and foreign markets; an increase in capital investment in the country by accumulating capacities and asset bases. As seen in Chart 6.3, domestic investments of banks in Qatar between the period 2004 and 2008 increased 150 percent. The total domestic investment of banks in Qatar in the year 2004 was less than QAR nine billion, growing in a five year period to over QAR 22 billion.



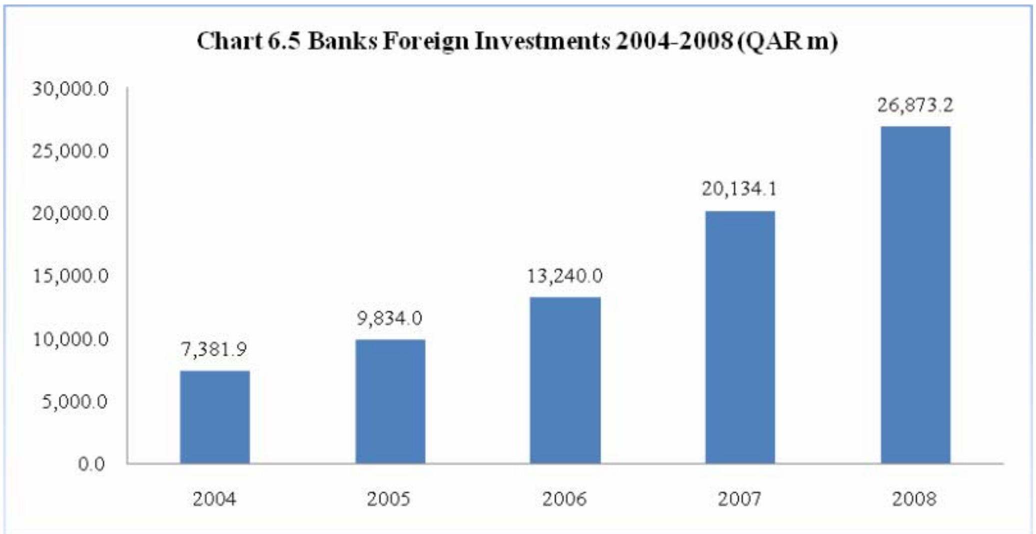
Source: Qatar Central Bank, 2009b

These investments are essentially in financial instruments. In addition to this, the banks have also been investing significant resources in fixed assets as they have expanded their operations as shown in Chart 6.4. The total fixed asset investment undertaken by all banks together was QAR 3 billion in 2008. This



Source: Qatar Central Bank, 2009b

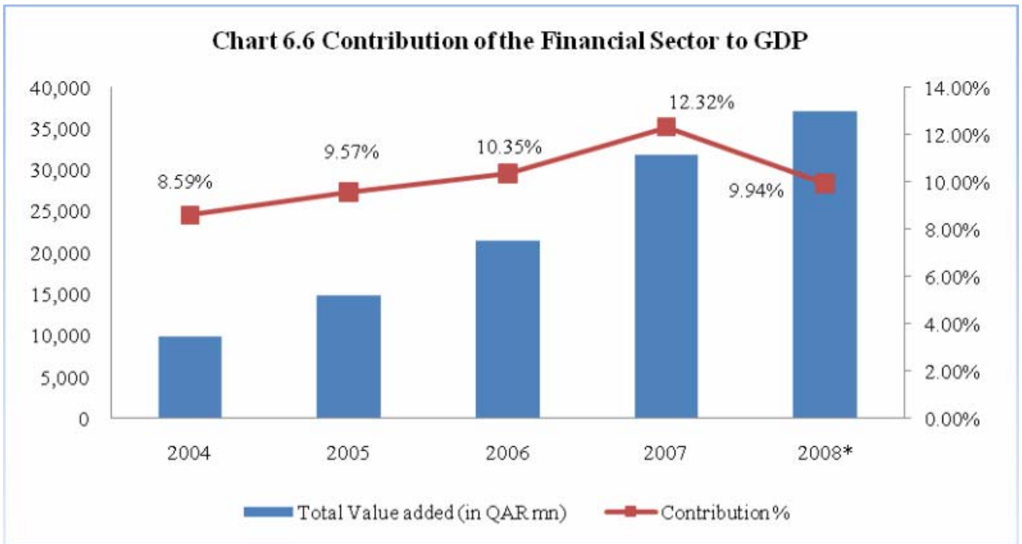
was an increase of over 291 percent from the QAR 771 million seen in 2004. This increase in capital expenditure by the banks has added to the economy's capacity--building efforts on the one hand and contributed to the growth of allied industries on the other. Banks have also been active investors in international markets. The banks in Qatar have an active portfolio of financial instruments issued by entities present in foreign countries (Qatar Central Bank, 2009c). These investments, though they do not have the multiplier effect typically associated with domestic investments, have contributed to the dilution of risks emanating from a concentration of domestic assets in banks' portfolios. Chart 6.5 shows the extent of the growth of foreign investments by banks in Qatar.



Source: Qatar Central Bank, 2009b

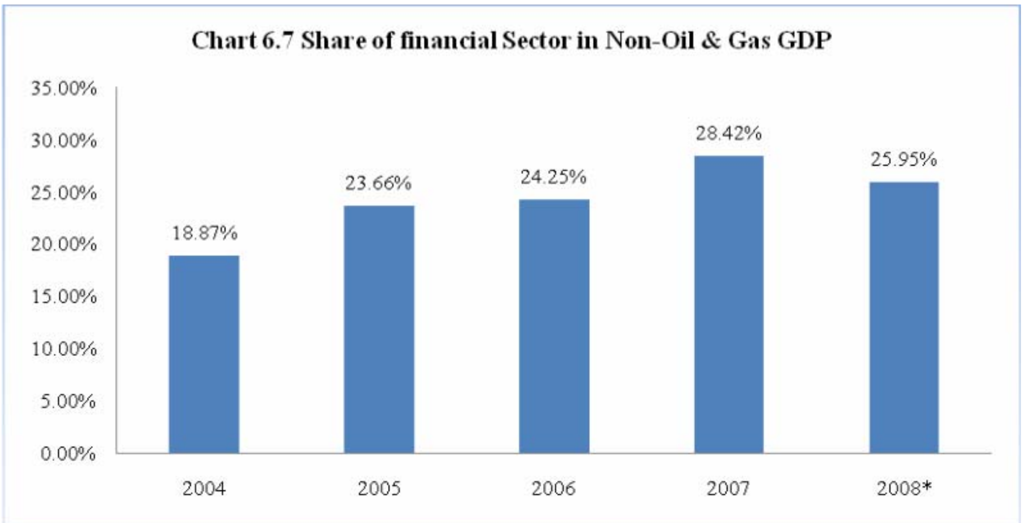
Total foreign investment by banks in 2008 was QAR 26.8 billion. This was an increase of over 264 percent from the QAR seven billion seen in 2004. It can be observed that the banks hold a larger share of their portfolio in the form of foreign, rather than domestic instruments. This, as discussed in the previous chapter, is due to the limited nature of investment opportunities that are present in the nascent financial markets of Qatar. The role of banks and other financial institutions as investors in domestic markets helps to increase the overall level of capital expenditure in the country and has a multiplier effect which benefits other industries as well (Frank *et al*., 2007). On the other hand, the investments in foreign economies by banks help to diversify their asset bases. The present climate in the international market will help shift focus onto investments in the region and in emerging markets as opposed to Western countries.

The discussion above reveals an improvement in credit advances in favour of the private sector as well as an increase of non-oil and gas sectors in the economy. This is a good indicator that the government is moving towards achieving its ultimate objective of creating a multi-sector economy, albeit slowly. A significant and direct indicator to assess this diversification of the economy is through the value-addition generated towards the GDP. Chart 6.6 shows the contribution of the finance, insurance, real estate and business services sectors to Qatar's GDP. As can be observed from the below chart, the contribution of the entire sector to the GDP was QAR 37.02 billion in the year 2008 at current prices. The global slowdown and the sharp fall in investors' appetite for risk,



Source: Qatar Central Bank, 2009b

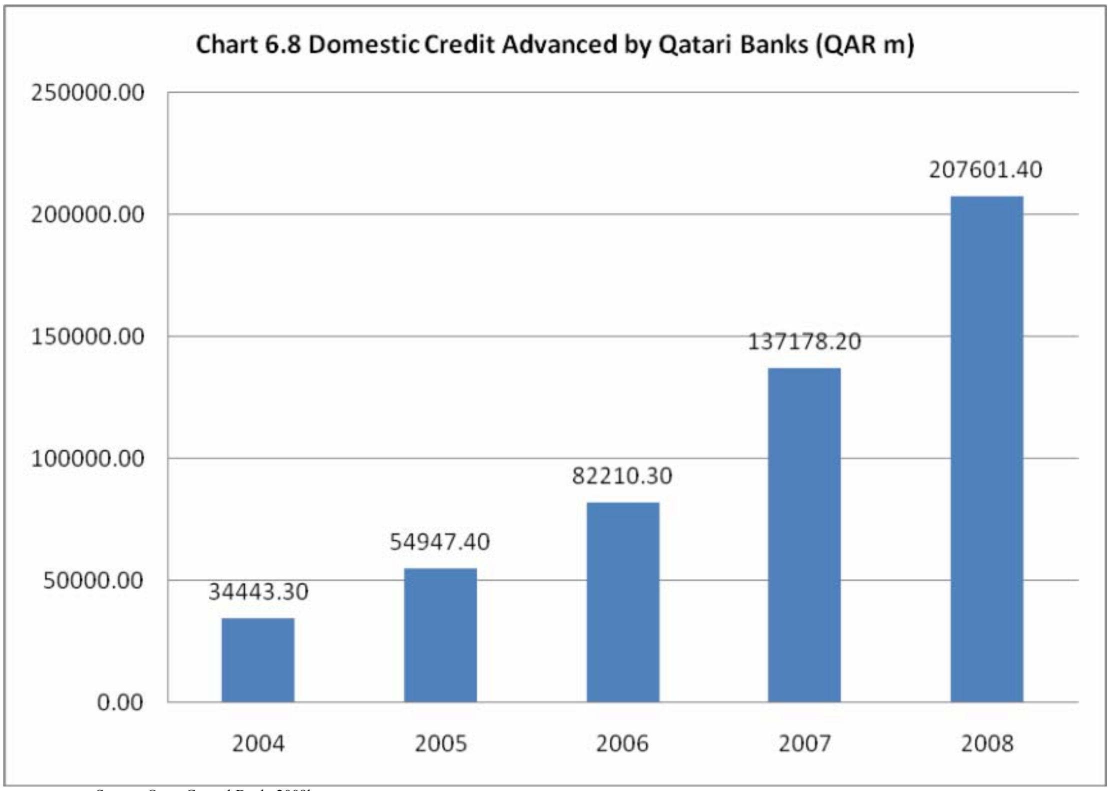
along with the reversal in the real estate sector seen during 2008, affected the financial sector as a whole, resulting in the decline of the contribution to GDP from 12.32 percent in 2007 to 9.94 percent in 2008. Even though the absolute level of contribution increased at a healthy pace of 16 percent, the sharp decline in relative contribution was due to the sector lagging behind the other sectors in the economy. However, a better understanding of sector contribution can be seen from the share of financial services in the country's non-oil and gas GDP, as shown in Chart 6.7. It can be seen that the finance sector's contribution to non-oil and gas GDP increased at a steady pace from 18.87 percent in 2004 to 28.42 percent in 2007. Nonetheless, the trend was reversed in 2008 when the contribution declined to 25.95 percent. If the oil and gas factor is taken out of the equation, the growth of the financial sector during a five-year period from less than 19 percent to around 26 percent is notable.



Source: Qatar Central Bank, 2009b

While a direct contribution to GDP could be easily monitored from the national accounts, the indirect contribution of the financial sector to the economic product can only be inferred from the data. Qatari banks were fulfilling one of their most important functions; that of channelling credit to businesses and individuals and translating savings into investments. In a market such as Qatar's, where investors tend to prefer less volatile investments and where financial investments such as equities are less popular, banks have played a very important role by taking deposits and lending to businesses and individuals in need. Bank credit typically produces a much larger impact due to the multiplier effect. Domestic bank credit increased 502 percent between 2004 and 2008 as seen in Chart 6.8.

The expansion of credit by banks makes capital easily available and contributes indirectly to growth in GDP. However, the banks in Qatar expanded credit at a pace that exceeded the growth in deposits and banks were lending out of their own capital.

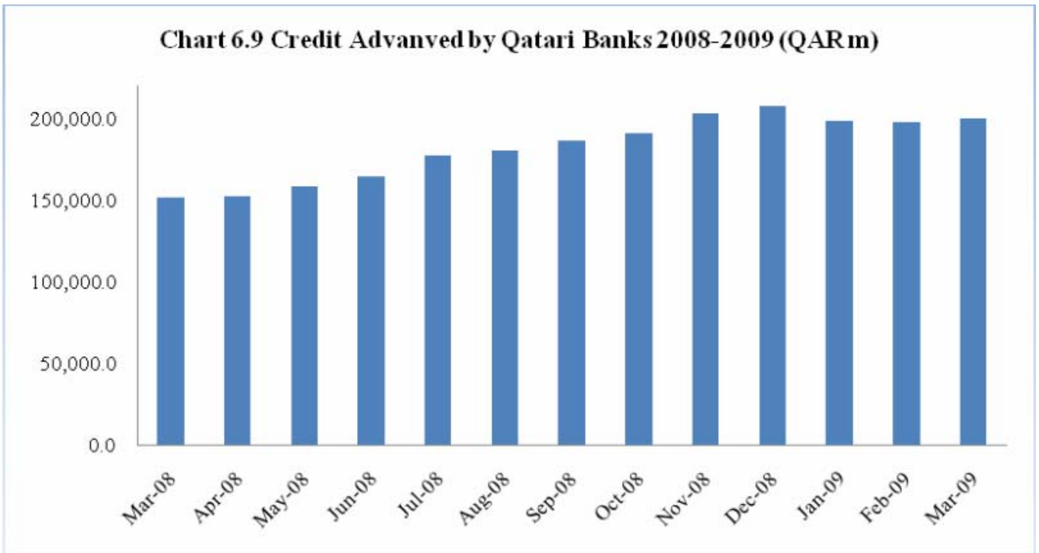


Source: Qatar Central Bank, 2009b

Source: Qatar Central Bank, 2009b

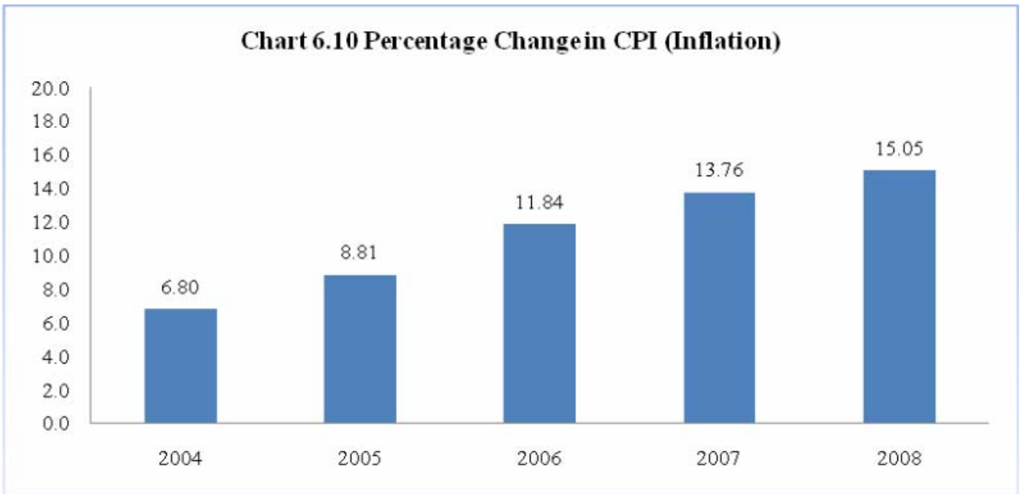
This massive expansion in credit contributed significantly to the surge in GDP which on a current prices basis rose by 44 percent in 2008. However as real estate turned down and other businesses suffered due to global slowdown, the banks suffered from a liquidity crunch and the Qatari government was obliged to infuse capital into all major banks in the country (QNB Capital, 2009). Notwithstanding the arguments regarding the prudence behind embarking on relentless credit expansion by banks (Standard and Poor's 2008) it is evident that the credit expansion *per se* played an important role in the sharp rise seen in Qatar's GDP in recent years. Banks have been instrumental in helping Qatar recover from economic slowdown through sustaining the supply of credit in spite of the increase in risks associated with lending.

It can be observed from Chart 6.9 below that the credit quantity which declined marginally during the first two months of 2009 had already started to increase in March 2009. This is quite contrary to the behaviour of banks in the US witnessed during the same period. Kahn (1991) states "Fed does not control the availability of bank loans. Unexpected changes in the desired mix of loans and securities in banks' portfolios may partly or completely offset Federal Reserve actions to restrain or stimulate the economy". On the contrary the banks in Qatar have managed to sustain the flow of credit even during the adverse economic climate. This is expected to contribute towards earlier recovery in the economy in comparison with the developed economies. Since July 2008, the ratio of advance to deposits has been consistently above one. Thus the banks have not allowed the decline in deposits to affect their lending ability. This is helped by the recapitalisation of banks in October 2008 (QNB Capital, 2009).



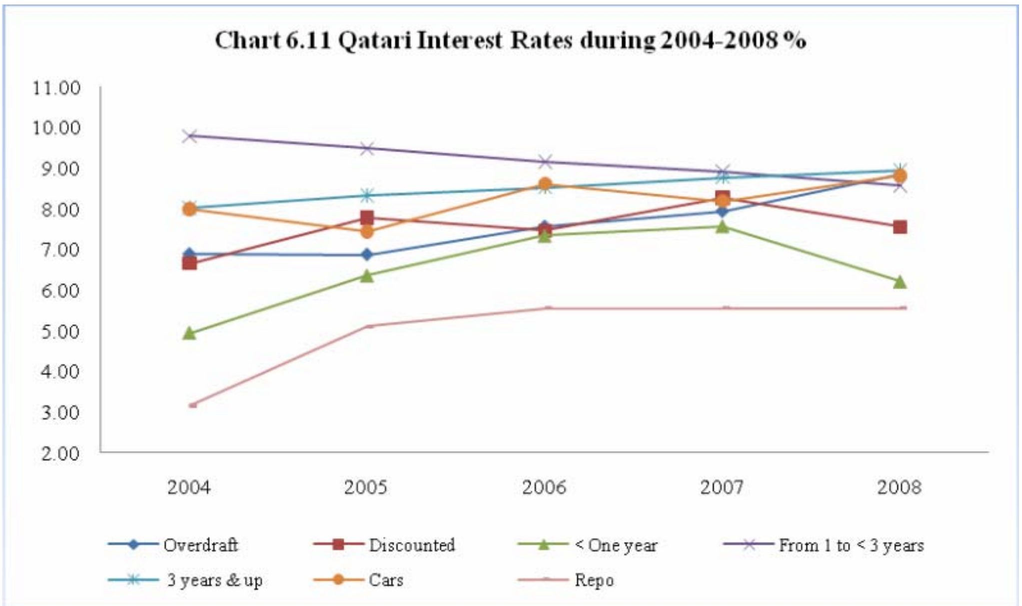
Source: Qatar Central Bank, 2009b

Another important indirect contribution of the financial sector, particularly the banking subsector, is that it is the main channel through which the monetary policy formulated by the central bank gets transcribed into action. However, as mentioned previously, the national currency is pegged to the US Dollar and, subsequently, monetary policy changes in Qatar closely resemble those carried out by the Federal Reserve in the US. Inflation in Qatar was in double digits due to the sharp run-up in asset prices before they pulled back in 2008. Chart 6.10 shows the percentage change in the Consumer Price Index during recent years.



Source: Qatar Central Bank, 2009b

Qatar Central Bank (QCB) implements a number of monetary measures including changes in repo rates, changes in interest rates, open market operations etc. However, the quantity of money in circulation is influenced by the monetary policy changes made by the QCB through changes in lending and deposit rates carried out by the commercial banks in the country. QCB also influences the credit practices of the banks and so can alter the quality of lending (Lybek and Morris, 2004). Chart 6.11 shows the recent movements in various interest rates along with the repo rate.

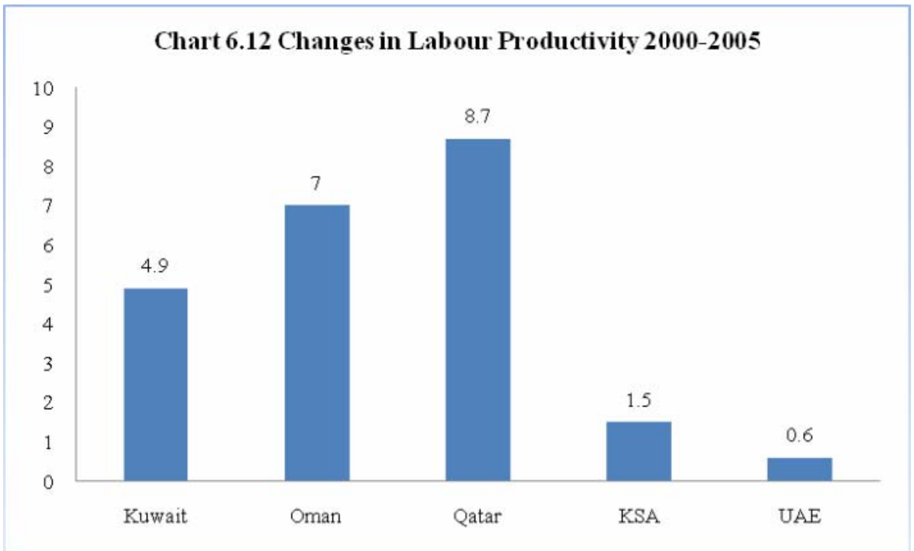


Source: Qatar Central Bank, 2009b

It can be observed that the short-term interest rates including overdraft rate, bill discounting rate, rate on credit for less than one year etc., are altered by banks to match the changes in the repo rate. This function performed by the banks ensures that monetary policy changes get translated into changes in the quantity of money in circulation. This is an important monetary role played by the banks. Changes in interest rates also indirectly affect variables such as insurance premiums, brokerage rates etc., which are determined by other players in the financial sector (Mahadeva and Sinclair, 2005). Thus the financial sector helps the QCB to bring about effective changes in the monetary condition of the country. In other words, the financial sector micro units act as the conduits through which the effects of monetary policy changes trickle down to the final consumer in the economy.

6.2.2 Contribution to Employment

Financial intermediaries have played an important socio-economic role by extending financial services to a variety of businesses, thereby stimulating entrepreneurship among the local population. Banks and other financial institutions have also nurtured local talent through employment and have improved the employability of the population through training and development programmes. This has contributed to an increase in productivity of the local population, which in turn has improved their earning capacity. It can be observed from Chart 6.12 that labour productivity in Qatar has been the fastest growing among comparable GCC economies.



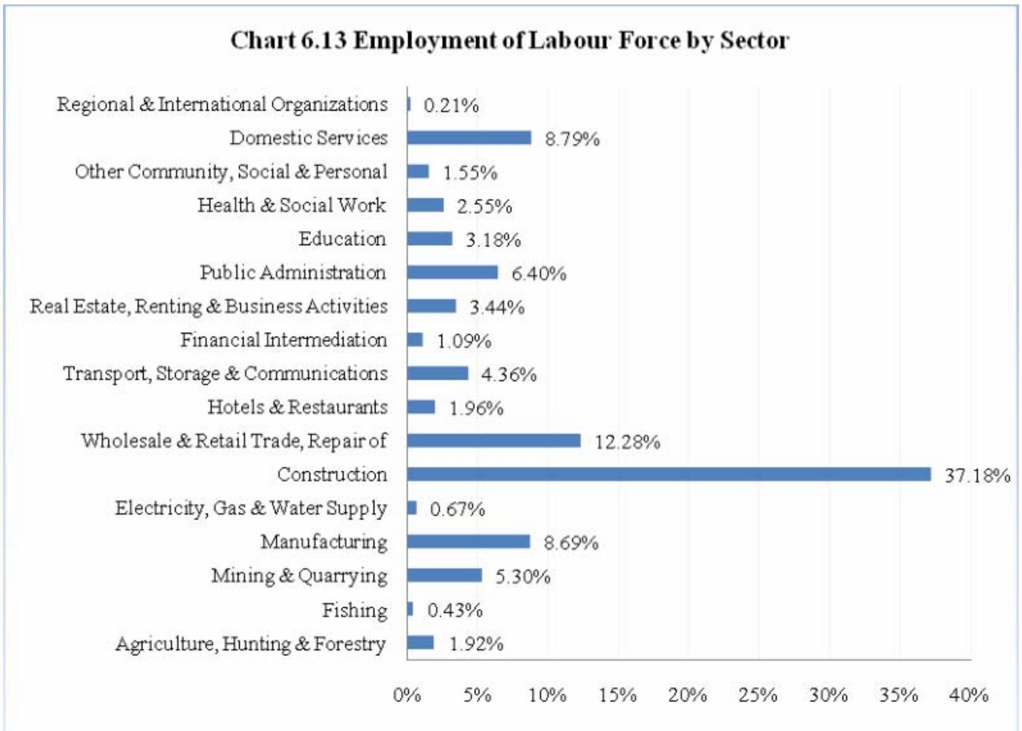
Source: Harb (2008)

One specific noteworthy socio-economic role played by the financial sector is that of employer of a female workforce. It is identified that about one-third of the total workforce in Qatar's banks are female (Qatar Statistical Authority, 2008). About 31 percent of Qatari banks' employees are drawn from the female population, while European banks in the country have a higher percentage (46 percent) of females in their workforce. About 22 percent of the workforce employed by foreign insurance companies is female while the percentage is lower at 14 percent and 16 percent for Qatari insurance companies and Arabic Insurance companies respectively. The national average for female employees among the workforce is much lower at 12 percent.

Chart 6.13 below shows the distribution of the labour force between the various industries and sectors in the economy. It can be observed that the construction sector accounts for over one third of the total labour force in the economy. Financial intermediation, which includes banks, insurance companies, brokerage houses, money exchange companies and the stock exchange and allied services, accounts for a little over one percent of the total work force. Thus, in terms of total workforce, the financial sector does not account for any significant percentage. This is an area where labour reform and policy of Qatarisation of the workforce could make quite an impact. This would naturally require an appropriate strategy of training and development of the Qatari workforce and a change in ethics in favour of seeking employment in the private sector. Qataris still prefer employment in the public sector based on a belief that it is more prestigious. QFC is expected to play a big role in the training and development of local talent to work in financial services. **The phenomenal economic growth witnessed in Qatar** in recent years and the chronic shortages in the labour market create a unique and challenging situation for the Qatari government, as it attempts to create a competitive financial centre and diversify its economy away from the hydrocarbon sector. The ambitious policy of Qatarization and the determination to develop a vibrant labour workforce are at the centre of the government efforts in its strategic policy of diversification and labour nationalization.

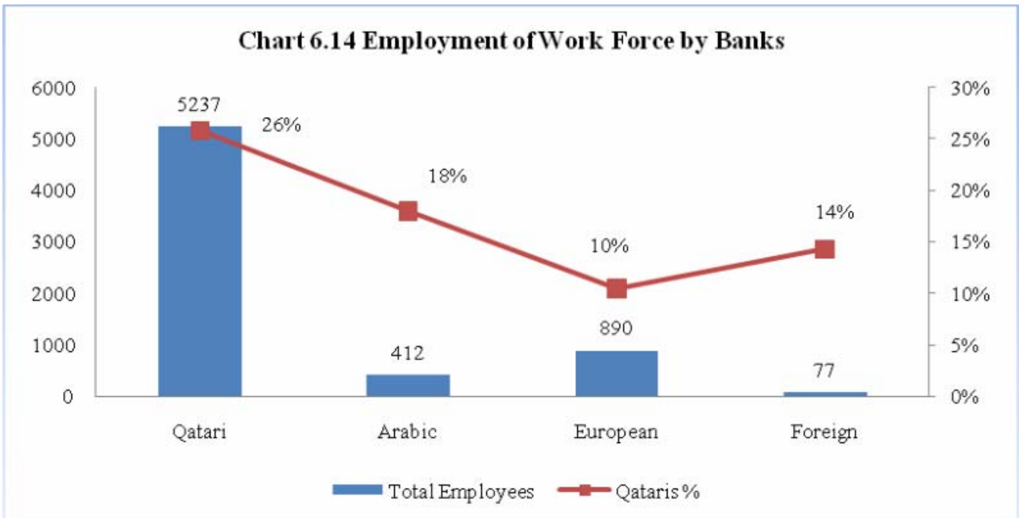
The key challenge facing Qatar as it endeavours to develop the labour market is to formulate policies and reforms that will help develop a domestic workforce with the skills and incentives needed to work in the economy's most important and competitive positions. The extraordinary economic growth over recent years is creating a high level of demand for skilled labour, which continues to exceed the supply available among Qataris and is creating shortages for qualified Qataris to lead the nation's industries. The composition of the labour market where the state provides generous public sector employment diminishes incentives for Qataris to acquire valuable skills and to work in the private sector. This is holding back the development of Qatar's financial hub ambitions and limiting the contribution of the financial sector to economic growth and diversification.

Qatar is working hard to overcome these constraints and to develop its workforce by subsidizing the establishment of local branch campuses of leading western universities. The Qatari government needs to move faster in its effort to highlight the advantageous of working in the private sector and provide generous incentives for its citizens to develop the professional skills needed in the financial sector in order to lessen its dependence on foreign professionals and develop a workforce capable of competing in the international marketplace. It needs to spend more on education and training, which are vital to the strategic national objective of Qatarization and the successful participation in the global economy. Countries with similar GDP per capita levels invest on average twice as much in their students, which means that Qataris will join the labour market with less preparation than their counterparts from other countries (Berrebi et al, 2009). The government needs to accelerate the waiting time for government jobs and advance the educational and professional training required to obtain jobs outside the government in order to make Qatar a competitive financial hub and more successful in its efforts for economic growth and diversification. Labour reform will help generate jobs, employment stability and boost confidence in economic growth. Flexible labour laws would also boost **productivity and efficiency and put Qatar's economy on a strong growth path.**



Source: Qatar Statistical Authority (2007)

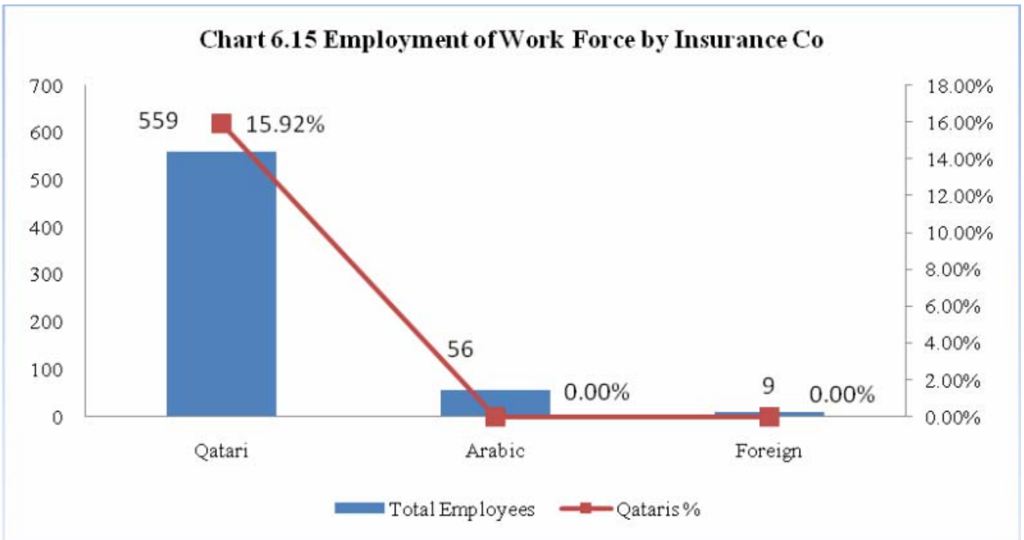
Chart 6.14 shows the total number of employees in all four groups of banks and the percentage of Qataris among those employees.



Qatar Statistical Authority (2008)

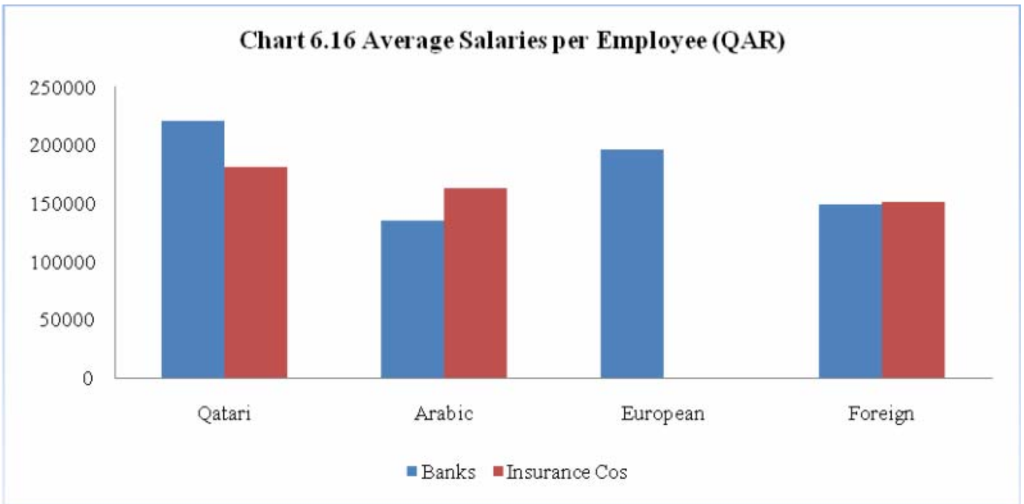
Qatari banks, as would be expected, employ the greatest number of employees, followed by European banks. The other Arab banks employ 412 persons while foreign banks account for only 77 employees. We see that about 26 percent of Qatari banks' employees are drawn from the local population. The percentage of Qatari employees in Arab banks is 18 percent. European banks have only ten percent of employees from among the local population while other foreign banks have a slightly higher ratio at 14 percent. The average percentage of Qataris among employees in the banking sector in Qatar is 17 percent. It is obvious that foreign and European banks prefer to employ non-Qataris while Qatari and Arab banks show a higher affinity to Qatari employees.

Chart 6.15 below shows the total number of employees on the payrolls of different groups of insurance companies and the percentage of Qataris among them. We see that Qatari insurance companies are the largest with total employee strength of 559. Arab insurance companies employ a total of 56 persons, while the foreign insurance companies have just nine employees in total. About 16 percent of employees of Qatari insurance companies are drawn from among the local population, while the Arab and Foreign insurance companies do not have any Qatari employees on their rolls. Insurance companies have 624 employees in total.



Qatar Statistical Authority (2008)

The following chart (Chart 6.16) shows the average salary paid per employee for each group of banks and insurance companies. It can be observed that Qatari banks pay the highest average salary followed by European banks, other foreign banks and Arab banks. Among the insurance companies, Qatari companies pay the highest average salary per employee followed by European, foreign and Arab companies. The average salary of a bank employee is QAR 175,118 while that of an insurance company employee is QAR 165,295. The average salary in Qatar is QAR 94,099. The average salary in the financial sector is QAR 139,560. This shows that the financial sector pays significantly higher than most other businesses in Qatar.



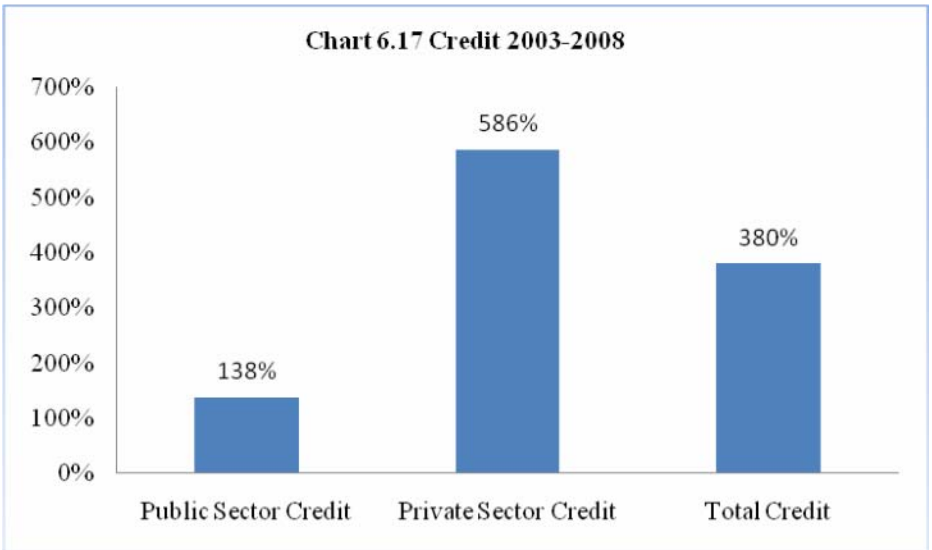
Qatar Statistical Authority (2008)

The above discussion indicates that although the sector employs a high percentage of Qataris who are paid the highest average salaries, its overall contribution to employment is very limited. This is one of the challenges facing this sector as an essential component of diversification; it needs to expand on its ability to create job opportunities especially for Qataris.

6.2.3 Private Sector Expansion

The government of Qatar has been trying to increase private sector participation since 2001 and has gradually either fully or partially privatized key institutions. It has transferred the responsibility of the state-owned electricity and water corporations to an independent authority; it partially privatized Industries Qatar and Qatar Gas, privatized telecommunications and Qatar fuel Company. Nonetheless, the private sector continues to represent a small portion of the economy. In this context the strategy of the government through the QFC is to focus on financial services as a means to expand private business activities and increase the size of the private sector in the economy.

Due to the paucity of data that directly covers the growth and development of the private sector, one of the ways to assess the expansion of the private sector is through the credit facilities that banks advance. Qatar has traditionally relied on the public sector for its economic growth and banks were used as sources to fund public sector enterprises. However, in tune with the government's policy of diversifying away from the public sector, the banks have been actively promoting credit expansion for private sector. During the period between 2003 and 2008, private sector credit, as a part of the total credit portfolio of the banks, increased from 54 percent in 2003 to 80 percent in 2007. Due to the contraction of the global economy, the credit off-take of the private sector declined in 2008 and the percentage of credit facilities to the private sector declined to 77 percent in 2008. Chart 6.17 shows the change in total credit and sector-wise credit between 2003 and 2008.

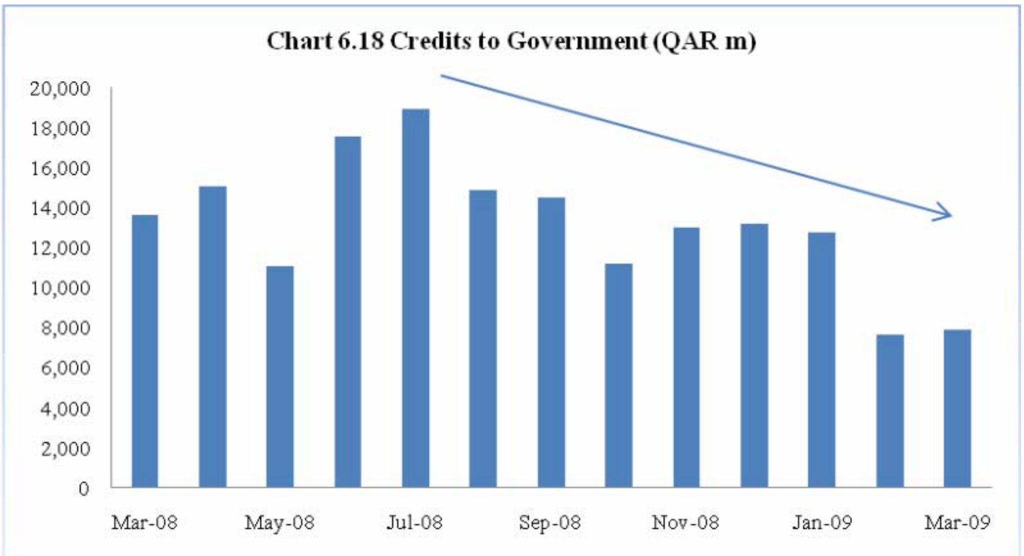


Qatar Statistical Authority (2008)

It can be seen that total credit increased by 380 percent. Total credit to the private sector increased by 586 percent, while credit extended to the public sector only increased by

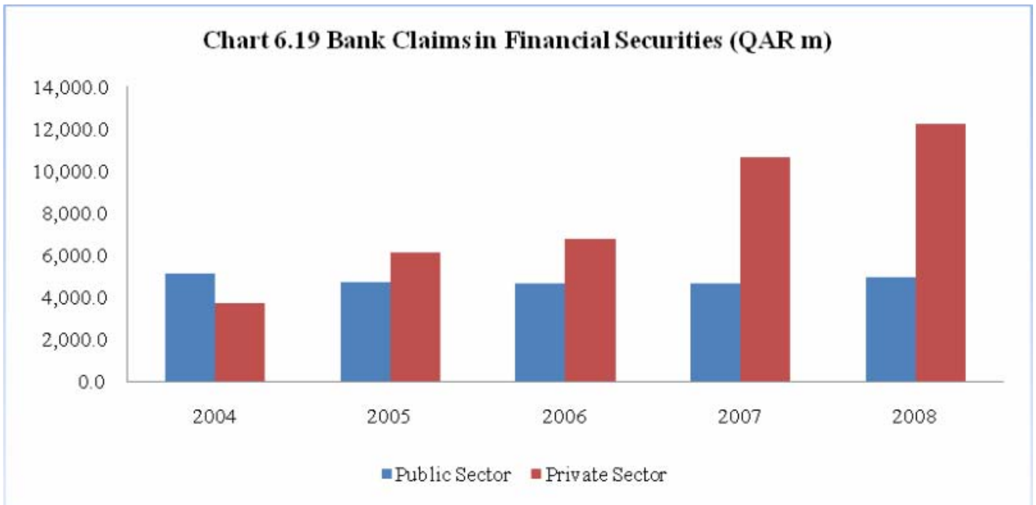
138 percent. This shows the clear push given by the banks to the private sector credit in Qatar.

The public sector includes credit extended to the government, government institutions, semi-government institutions and public sector enterprises which are majority owned by the government. It is can be seen from Chart 6.18 that direct bank credit extended to the government has been on the decline almost consistently since July 2008. The government has realised the tight liquidity condition in the market and has purposefully shrunk its credit requirements of banks sharply. A similar trend is witnessed in the credit off-take of government institutions and semi-government institutions. On the other hand, public sector enterprises have been allowed to enjoy small increases in credit supplied to them. However the overall public sector credit increase has lagged behind the increase seen in the credit extended to private sector since the economic slowdown set in.



Source: Qatar Central Bank, 2009b

Apart from direct credit, the banks also lend to public and private enterprises through the purchase of securities issued by government and private companies. Banks' investment in government securities has been stable during recent years. Chart 6.19 shows the size of investment in government-issued financial securities and private sector financial securities.



Source: Qatar Central Bank, 2009b

While the claims on account of financial securities issued by the government remained stable below the QAR five billion level, the investment in private sector financial securities increased 227 percent between 2004 and 2008. This is in line with the push towards private sector lending which the banks embarked on in 2003.

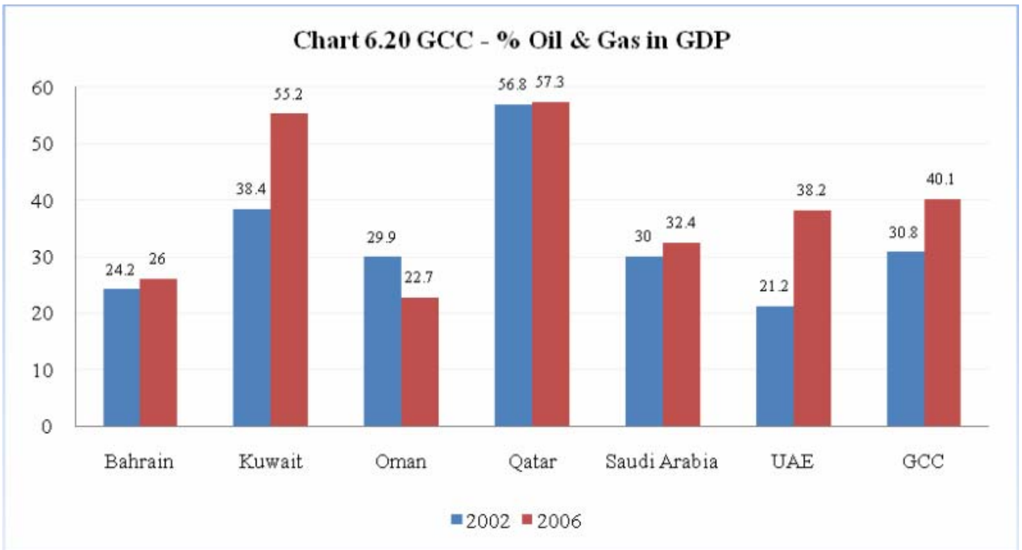
The above discussion suggests an important but limited contribution of Qatar's financial sector to economic diversification. The mall size of the market and the limited economic opportunities, in addition to the constraints of the labour market, mean it will take more time and effort on the part of the government and the private sector to take advantage of the opportunities and potential that exists for the sector in the Gulf region and the Arab region as a whole. In this context the question remains: is the creation of QFC the best option to direct and impact on the growth and development of the sector as part of the strategy of economic diversification? The following discussion will attempt to answer this crucial question.

6. 3 The Role of Qatar Financial Centre

The government of Qatar has been promoting QFC as an integral part of Qatar's future economic prosperity and as part of its strategy to increase the role of the financial sector as a main contributor to its strategy of economic diversification. It is evident that the government is pinning its hopes on QFC quite strongly and backing it with huge investments in infrastructure, and it is expected to continue to grow rapidly over the next few years, fuelled by large-scale investment (Qatar Financial Centre, 2009a). The government states that QFC has been created "to support the development of Qatar and the wider region, develop local and regional markets, and strengthen the links between the energy-based economies and global financial markets" (Qatar Financial Centre, 2009a). The reasons for the crucial role that QFC is expected to play in Qatar are multiple. QFC is expected to become a lynch-pin of the government's highly ambitious diversification policy. On the other hand, QFC is also expected to leverage the growth which the GCC region is expected to undergo in order to gain foreign revenue and service exports for Qatar. These two points, though not spelt out in so many words by the authorities are at the core of the importance attributed to QFC by the government and other authorities in the country. In addition, QFC is expected to be heavily involved in enhancing the competitiveness of the sector by attracting foreign capital, promoting transparency, improving regulation of the sector and promoting Qatar brand. This section analyses these expected roles in detail.

6.3.1 Enabler of Diversification

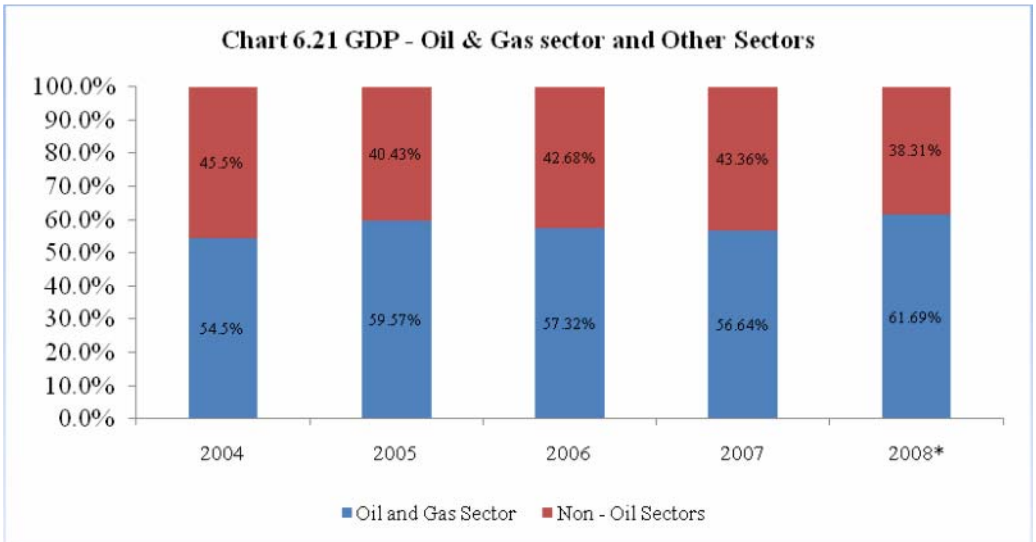
All of the GCC countries, and particularly the three dynamic ones: Qatar, the UAE and Bahrain, have been following a policy of economic diversification for over a decade. As mentioned previously, the decline in crude oil prices in the 1980s drove home the point that crude oil could be an important resource behind economic development but may not remain so forever. Since then the GCC countries have realised the need to diversify their way out of dependence on fossil fuels. For Qatar, the government has been investing significant capital into various industries to jump-start the growth of those services and manufacturing sectors not dependent on oil and gas sectors. QFC forms an integral part of the government's economic diversification drive and this crucial importance of QFC can be understood from the data presented below. It can be observed (Chart 6.20) that the economic diversification policy undertaken by many GCC countries has had a limited impact.



Source: Saif (2009)

It is noticeable that the oil-dependence measured in terms of oil and gas sectors contribution to country's GDP has grown for every GCC country except Oman. For Qatar, the diversification policy is of greater importance than for any other GCC economy because it is the country with the highest degree of oil-dependence. Oil and Gas sectors formed 57.3 percent of the total GDP in 2006.

The chart below (Chart 6.21) shows that the contribution of the oil and gas sector to Qatar's GDP has grown in spite of the massive investments made in developing alternative sectors. In 2008, due to record oil prices, the oil and gas sector GDP was 61.69 percent of the total GDP. It is hoped that the creation of a world-class infrastructure for international finance companies to come in and set up a base in order to tap the opportunities provided by the region in general and the country in particular is considered an important strategy to ensure the development of the finance sector in the country. This in turn is expected to increase the contribution of non-oil and gas sectors and lead to a decline in the degree of oil-dependence of the nation.



Source: Qatar Central Bank (2009)

Up until recently, Dubai has been considered the most successful in its diversification strategy and the model to follow. Even though Dubai has a relatively smaller portion of its GDP drawn from oil-based businesses, the government has encouraged investments from abroad and from within sectors such as trade, manufacturing and services. However, the current financial crisis gripping Dubai has sent tremors around the global equity market with the shock request by Dubai's flagship government-owned holding company, Dubai World, for a suspension on repayment of part of its debt. The news resulted in a sell-off in Asia and heavy losses on Wall Street. The FTSE 100 had fallen by 2.3 percent and the Nikkei by 3.8 percent, while the Dubai and Abu Dhabi markets dropped 7.3 percent and 8 percent respectively (FT: 2009: 27 Nov). Such a severe reaction, to what some might consider a "Little pebble in the Gulf" is an indication of the fragility of the global market which remain over-leveraged and undercapitalized (*ibid*). In a way Dubai's USD 80 billion debt obligations to finance its diversification plans pales in comparison to Leman Brothers USD 613 billion of liabilities. Abdulrahman Al-Saleh, Director General of Dubai's Department of Finance, indicated that global markets had overreacted to the news but admitted that creditors to Dubai World would be affected in the short-term (FT: 2009). In order to ease fears about its banking system the UAE central bank set up an emergency liquidity facility and said it would provide lenders with access to fresh liquidity and pledged to stand behind UAE banks and branches of foreign groups (*ibid*). Abu Dhabi is coming under increasing pressure to come to the rescue of Dubai, however, it has always insisted that such issues have to be dealt with at federal level for the seven Emirates and it would not simply write Dubai a blank check. Nonetheless, the UAE needs to act swiftly because of the repercussion of the crisis on investors' confidence and on the financial stability of the region.

Qatar, however, is quite different from Dubai in its gradual and more cautious approach towards its diversification strategy, additionally; it has the gas reserves to support its long-term economic plans. QFC's involvement in the promotion of the country's financial sector through participation from international financial institutions in order to increase the contribution of financial sector to the overall GDP of the country must be approached with the same prudence that has characterised and differentiated Qatar from its neighbour, Dubai**. Qatar Financial Centre is in an excellent position to take advantage** of the meltdown in Dubai and increase its market share in the race for the Gulf financial centres' from its rival Dubai. The severe impact of the financial crises on Dubai's economy presents Qatar with a golden opportunity to compete with Dubai as the primary influence on the Gulf financial sector. Dubai, the once-gilded emirate, sees itself as a modern financial centre, yet reverts to authoritarianism and censorship in the face of bad press, and attempts to silence western media who question the performance and handling of its economy. Dubai's failure to provide free markets for investors by making access to information more readily available, open and transparent is causing serious damage to its economy. Confidence would be difficult to regain in Dubai, since the failure of Dubai World to honour its obligations shook the international investment community's faith in the emirate. Experienced analysts no longer trust the government statistics, claiming they do not fully reflect the amount Dubai owes its foreign creditors. While Dubai's economic miracle staggers and stumbles towards debt Armageddon, Qatar is quietly emerging from its neighbour's shadow, positioning itself as a rapidly diversifying, dynamic economy. The International Monetary Fund (IMF), in its most recent assessment of the economic outlook for the Gulf, said that Qatar's economy would grow by 18 percent in 2009, and would be the only member of the Gulf Cooperation Council to record double-digit growth. GDP in Qatar has increased on average 11.8 percent annually over the last three years, with per capita income reaching an astonishing $103,500 in 2008 (Washington Post Global: 2010: 27 June).

Qatar is also on course to be the regional financial centre of choice, according to Stuart Pierce, Chief Executive Officer and Director General of QFC. Its access to a varied array of energy and infrastructure-related projects make Qatar more likely to be an attractive proposition for investors, a point that the QFC is keen to exploit (interview, July 2008). Unlike Dubai, Licensed firms in QFC are an integral part of the Qatari economy, they can opt to operate outside of the QFC's immediate vicinity and take deposits, offer insurance and manage retail assets, which is what makes QFC different from Dubai, and better equipped to compete in the long run and capture a larger market share.

The QFC have done much the same in their bid to snatch Dubai's crown as the money centre of the oil world. The cream of the British judiciary, a chunk of Britain's Financial Services Authority, and an army of HSBC veterans have been recruited to create a 21st City finance hub in Doha. Qatar regulator, Philip Thorp, is a moral refugee from Dubai, where he blew the whistle on underhand property dealing and has since been amply vindicated by events.

Through the QFC Authority, civil and commercial disputes are dealt with by the QFC Court, presided over by Lord Wolf, the former Chief Justice of England and Wales. Sir

William Blair, brother of former British Prime Minister Tony Blair, chairs the regulatory tribunal.

Unlike DIFC, Qatar Financial Centre has developed a technology-based platform to serve the insurance and reinsurance market, which also includes Sharai-compliant Takaful. QFC has identified that insurance represents a gap in the market as a lot of insurance premiums go elsewhere in the world. Creating a regional market for insurance will attract brokerages to the QFC and could lead to Qatar becoming a regional force, according to Steve Martin, Director of Marketing and Corporate Communications at QFC. Creating a regional market for insurance will attract brokerages to QFC and could lead Qatar to becoming a regional financial force.

As it is new to the market, Qatar can sidestep legacy processes and outdated technology. The QFC is building an 11,000 square foot teaching facility in Doha for partner organisations that currently include the institute of Cost and Management Accountants and the Chartered Insurance Institute, both from Britain. Qatar is also building the new Barwa financial district in the new Lusail city and QFC is on track to become a much bigger player in regional financial services as well as a more formidable competitor in global financial services. As the Dubai phenomenon ends in a mangle of half-built towers and unpaid debts, regional leadership is shifting along the Gulf cost to the seriously rich gas sheikdom of Qatar.

By 2012, Qatar would be producing 5.5m barrels a day of oil-equivalent: half Saudi Arabia's output. Qatar aims to build a hi-tech industrial hub manned by home-grown engineers and chemist. Qatar economy has been growing 20pc annually, the fastest in the world and the lure for banks is to play a full part in the $130bn of projects scheduled over the next five years(Gulf Times, 2010).

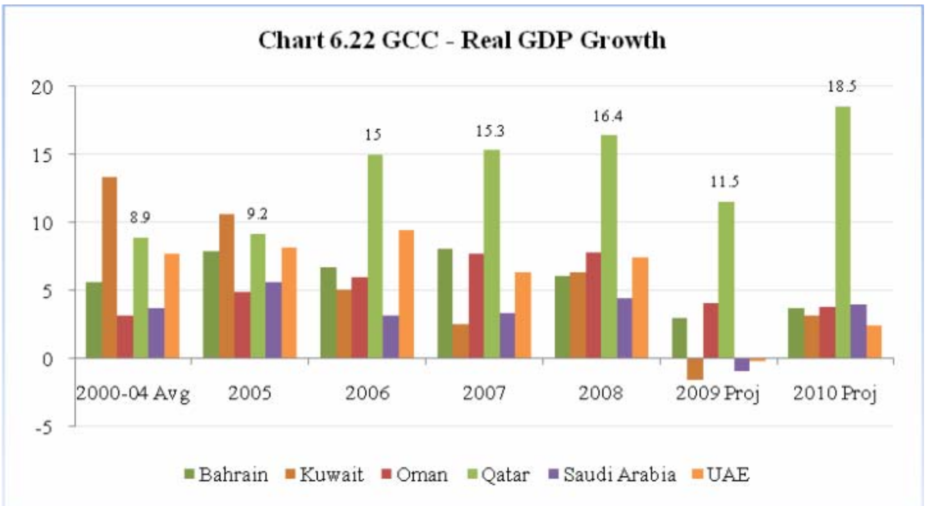
Qatar has sharpened its regional competitive edge with the Cabinet's amendment to investment law allowing 100 percent foreign ownership in the sectors of technical and consultation services, information and technology, and distribution. The amendment also loosens the controls on foreign ownership in nine other sectors, broadening ministers' scope in lowering barriers to foreign ownership (The Peninsula, 2001). Qatar's decision paves the way for attracting foreign capital otherwise restricted by ownership limitations in the region. This development is extremely timely, as Qatar strategically positions itself as a safe haven for foreign investors. Qatar is ranked as the highest in the Middle East in terms of business confidence (Ibid).

In order for Qatar to succeed in its endeavour of attracting foreign investment, it is beneficial to undergo further reforms to streamline the ability of foreigners to establish businesses in the country. Sustainable development of infrastructure is also of major **significance in drawing a larger number of foreign investors from Dubai.**

Qatar, however, is quite different from Dubai in its gradual and more cautious approach towards its diversification strategy, additionally; it has the gas reserves to support its long-term economic plans. QFC's involvement in the promotion of the country's financial sector through participation from international financial institutions in order to increase the contribution of financial sector to the overall GDP of the country must be approached with the same prudence that has characterised and differentiated Qatar from its neighbour, Dubai.

6.3.2 Conduit to leverage GCC growth

Qatar's GDP grew at a rate of 12.7 percent during 2008, 9 percent during 2009 and is projected to grow 18.5 during 2010. This massive growth witnessed in the country since 2000 and the healthy growth rate seen in the GCC region has created a wide-spread need for financial services in the region. As the growth rate is expected to be healthy for other countries in the region and the growth rate of Qatar is expected to be 18.5 percent in 2010 (Chart 6.22) it is believed that the country and the region may see an increased need for financial services. Qatar is already a country with one of the largest per-capita income levels in the world. As the growth of the economy accelerates, the private wealth of individuals in the country may also see a steep rise. This could give rise to an increase not only in the quantity of financial services demanded but also the quality. In order to meet the increased



Source: International Monetary Fund (2009)

quantitative demand, the government has to ensure that more financial services firms are provided with licences, and to meet the increased qualitative demand, it should ensure that international financial services companies with long track records and regulatory compliance are provided permission to operate in the country. As these kinds of international financial institutions find the domestic corporate law and business services unappealing, there is a need to create a niche where they could enjoy a set of services of international standards and be given adequate freedom to seek and compete for a larger share of the market. The government believes that QFC fulfils this need of international financial institutions and encourages them to set up a base in the country thereby leveraging the expected steep growth of domestic and regional economies. The government states that "Apart from Qatar itself, the QFC also provides a conduit for financial services providers to access to over USD 1 trillion of investment in the rapidly-growing financial markets across the GCC as a whole over the next decade" (QFC, 2009a). It needs to be seen how giving these international institutions access to the pie in the region will help develop Qatar's financial sector to the benefit of Qataris and the region. Perhaps more attention should be given to meeting this expected increase in demand from within the region itself by enhancing the capacity of the companies that already exist in the region.

6.3.3 Attract Foreign Financial Institutions

Most of the GCC countries, including Qatar and the UAE, have corporate laws that are heavily biased in favour of the local population. Majority stakes in every company in these countries have to be owned by a local individual or company. This places serious restrictions on foreign interest in these nations. The only legal way for foreign financial institutions to operate in these countries is through joint ventures with local companies. This is seen as a factor in hampering the growth of many industries, particularly the financial services sector. In order to circumvent these provisions in local law, countries such as Qatar, Bahrain and Dubai have created financial free zones – Qatar Financial Centre, Bahrain Financial Harbour and Dubai International Financial Centre respectively to allow international financial institutions to set up and be entirely owned by foreign nationals and foreign companies.

It is believed that QFC would attract foreign financial institutions because of the liberal foreign ownership policies and the scope for growth in Qatar and the GCC. Also, it is evident that companies that are incorporated within a country that is part of the GCC are treated preferentially over foreign companies while being considered for licences by other countries' regulatory authorities. Thus the foreign institutions that get incorporated in QFC would gain a local identity which may prove useful to obtain licences and set up bases in other fast-growing economies in the region including the UAE, Bahrain, Kuwait and Oman.

6.3.4. Promote Transparency

One of the main reasons for the hesitance of international financial institutions to set up base in the region in spite of the explosive growth opportunities is the lack of transparency in the system. While local legislations are quite different from those usually seen in the UK, the US or European countries, poor governance and lack of transparency have been major problems for foreign institutions in many GCC countries including Qatar. Besides, the entire process of licensing is perceived as difficult in nature with no clear guidance on the requirements. This has affected the growth and entry of foreign institutions in Qatar.

However, QFC has special legislative and judiciary authorities that are structured perfectly in line with the practices commonly found in developed financial markets, which makes it easier for the financial institutions to incorporate and manage. The governance and transparency standards in GCC countries need much improvement, however Qatar is still better off than Bahrain, Oman and the UAE in terms of governance (Saif, :2009). According to the World Bank ranking of GCC countries in terms of ease of doing business, Qatar ranks ahead of Kuwait, the UAE and Oman but lags behind Saudi Arabia and Bahrain in the GCC (World Bank: 2009). The constitution of a separate regulatory structure and judiciary system for financial services on the one hand would help to increase the overall level of governance and transparency in the country but on the other it runs the risk of undermining local business. The creation of two parallel systems in the country, one for foreign and one for local businesses cannot be a beneficial way forward for the long-term prospects of the country's financial sector. Local businesses need to be supported and encouraged to comply with international standards and regulatory requirements, not left to operate under a less rigorous and less transparent system.

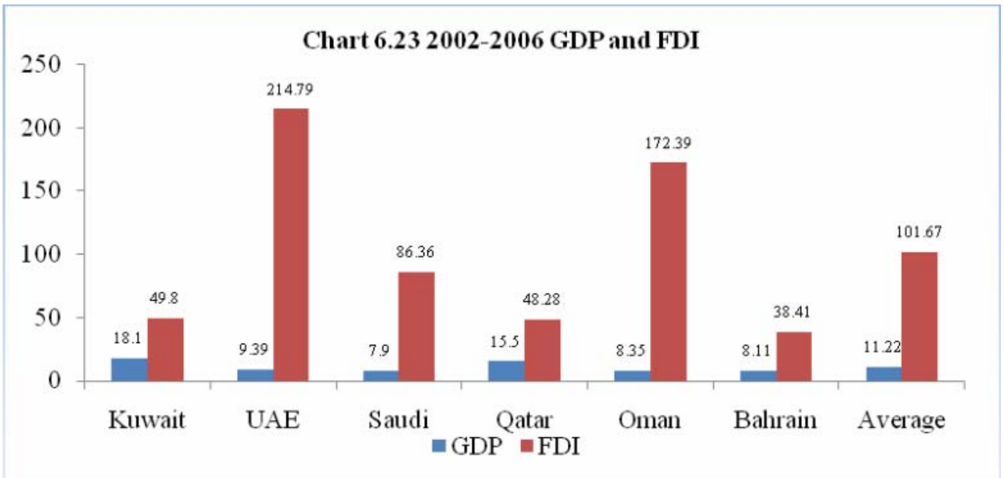
6.3.5 The Regulatory Structure of International Standards

Those developed countries with advanced financial markets, such as the UK and the US, were thought of as having established strong regulatory structures for their financial institutions (banks, broking houses, insurance companies, and investment houses etc.) which deal with customers' funds on a regular basis. The current global financial crisis questioned the efficiency and competence of these regulatory bodies and in the process created a lot of scepticism about the validity and usefulness of these structures. Regardless of the inadequacies of the Western model, it is still the source for international standards that many developing countries are striving to implement. The GCC countries are no exception. Their regulatory structures are considered very fragile, in view of the nascent nature of their financial markets and hence their regulatory authorities are at the beginning of the learning curve.

In a way, they are at an advantage as they can avoid the pitfalls of what happened in the West and can learn from the mistakes of Western regulatory bodies. QFC was hoping to alleviate the regulatory risk by ensuring a high-quality regulatory infrastructure constructed on the basis of the existing structure in the UK and the US. This has been the trend followed by all the financial free zones in the GCC including the Bahrain Financial Harbour and the Dubai International Financial centre. QFC Regulatory Authority has created deals with regulatory agencies in the US and the UK in order to inherit their regulatory structure in QFC. Philip Thorpe, Chairman and CEO of QFC Regulatory Authority, says, "We believe it is important that an institution is being supervised by their home state regulator as they can offer a prudential oversight such as looking at the balance sheet, while we look after everything else" (Aaron, 2007). This approach, considering the failure of these regulatory systems to predict or avoid the current financial crisis, might have to be slightly adjusted to take into account why and how these systems failed to protect the funds entrusted into these financial services, whether in banks or non-banking institutions. Qatar, as well as the rest of the GCC, needs to improve on their regulatory infrastructure in order to attract international financial intermediaries. This is expected to be a major contribution of QFC in its endeavour to enhance Qatar's attractiveness to foreign investors.

6.3.6 Promote 'Brand Qatar'

Qatar is actively engaged in diversifying its interests away from oil and gas based industries, as has already been explained. The government has plans to spend over USD 130 billion over the next five to seven years in a number of sectors including health, social welfare, education and transport. It is believed that these investments would kick start the emergence of these sectors in the country which would then be followed by capital flow from the private sector as well as from abroad into these sectors. Qatar is well-known as the emerging power-house of gas reserves and an important player among crude oil suppliers. However, Qatar has not been very successful in attracting foreign investments into non-oil and gas sectors. Chart 6.23 below shows the comparison between GDP growth rate and rate of change of FDI inflow for all GCC countries along with the GCC average. It can be seen that Qatar had one of the highest GDP growth rates during the period 2002-2006. The average GDP growth rate of Qatar was 15.5 percent which was second only to Kuwait whose average GDP growth rate was 18.1 percent.



Source: Faras & Ghali (2009)

In spite of this explosive growth rate Qatar has not been successful in attracting FDI inflows as much as its peers. The GCC average has been a GDP growth rate of 11.22 percent and an FDI inflow change rate of 101.67 percent on a yearly basis. However the FDI inflows into Qatar have grown at a below-par rate of 48.28 percent per year during the five year period. The UAE, on the other hand has attained 215 percent growth rate in FDI inflows every year during this period inspite of having a GDP growth rate of 9.39 percent which is much less than the regional average. One of the reasons for this dichotomy between growth and inflows could be the promotion of brand. The UAE, particularly Dubai, has been expending resources in promoting the country as a brand, particularly in the developed countries such as the US and the UK. Qatar has recognised the need to promote itself but has not been very successful in implementing the plans. It is believed that QFC would play an important role in promoting Qatar as a preferred investment destination for overseas investors and institutions. In 2007 Qatar recorded the fasted growth in FDI in the MENA region of USD 1.1 billion, seven times larger than in 2006 (The Peninsula: 27 Sept, 2008). Nonetheless, foreign investment in Qatar has remained confined primarily to the hydrocarbon sector and there has been very little foreign investment in other sectors of the economy (World Bank: 2007). It is perhaps more prudent for foreign capital to invest in proven sectors of the economy than take risks in the more nascent ones.

6.4 The Impact of the QFC on the Economy

Qatar Financial Centre distinguishes itself from other peers in an important way in that the businesses incorporated within the QFC are allowed to transact business with clients outside the zone and can also deal in their currency of choice. Because of this feature, it is expected that the growth in QFC will be reflected in the growth of the entire financial sector in Qatar. In strictly off-shore financial centres, such as Dubai International Financial Capital (DIFC), the members are restricted to doing business with only certain classes of high net worth clients and those who are incorporated inside the zone. This places severe restrictions on the businesses and the compulsion to deal only in USD may also hamper the spread of benefits from the growth of DIFC into the mainstream domestic financial sector.

Since its inception in 2005, 115 companies have been licensed to carry out permitted activities in QFC (Qatar Financial Centre, 2009b). The permitted activities are classified into regulated and non-regulated activities. The regulated activities include a number of activities wherein the client's funds are transferred to the service provider in some form. The non-regulated activities include professional services such as auditing, management consulting, IT services, legal services etc (Qatar Financial Centre Regulatory Authority, 2009). The firms seeking to indulge in regulated activities need to obtain an authorisation to that effect from the QFC Regulatory Authority. Of the 115 firms licensed to operate in QFC, 68 companies have been authorised to provide regulated services to their clients. The regulated activities include investment banking, investment management, private equity, venture capital, etc. These firms, most of which are well-established in multiple regulatory domains around the world, attract foreign capital into the country because of the inherent attractiveness and steep growth of the country. Thus they act as conduits for the flow of capital into the country as well as the region.

QFC is the most recent financial centre among its peers. No official data is available on the volume of business transacted by the businesses incorporated in the financial centre. Therefore it is not possible to measure the direct impact of QFC on the economy. On the other hand, it is believed that QFC has played an important role in the growth of the financial services industry in the country. As discussed earlier, the contribution of the financial sector to the GDP has increased steadily, except in 2008 when the global financial meltdown caused a decline in the financial sector's contribution to Qatar's GDP.. It is believed that the QFC would have contributed to at least some part of this growth in the financial services industry.

QFC also includes the Qatar Finance and Business Academy (QFBA) which "is a specialised educational academy for the financial sector based in Doha under the auspices of the QFC Authority in partnership with Qatar Foundation (QF)" (Qatar Financial Centre, 2009c). The objective of QFBA is to impact finance knowledge to the human resources within the country and the region so that the country can develop into a knowledge-based diversified economy. QFBA already has over 300 programmes lined up for the next year (Othman, 2009). These knowledge initiatives are expected to have a profound impact on specialised financial services in the country.

6.5 Lessons from other Financial Centres

QFC is still in its nascent years as less than five years have passed since the creation of the Centre. However QFC has learned and incorporated a few major points into the structure, taking advantage of its relatively later entry into the financial centre competition in the region. Bahrain has been functioning as an off-shore financial centre for many years as the country has made it easy for foreign financial institutions, including banks, to set up companies in the country which leverage their regional incorporation to gain entry to closer and tougher markets such as the UAE and Kuwait. DIFC was founded in 2004 and has been more successful in attracting foreign financial institutions, primarily due to the more diversified nature of Dubai's economy of (Oxford Analytica, 2005). The following is a discussion of some of the lessons that Qatar has learned and problems it hopes to avoid in the operations of its financial centre.

6.5.1 On-Shore Financial Centre

One of the major aspects of QFC that distinguishes it from its closest rival, DIFC, is that QFC is not positioned as a financial free zone but as a business environment. In a financial free zone such as DIFC there are restrictions imposed in terms of scope of operation and regulation. In particular, the firms incorporated in the DIFC are not allowed to do business with firms incorporated outside the Centre. This condition is built in so that the firms in financial free zone do not compete directly with those incorporated under separate statutes (Wigglesworth, 2006). Besides, the companies in DIFC are essentially required to operate from within the DIFC area. This places an extra burden in terms of increased cost of operations due to heavy rent for offices, as DIFC is fast becoming one of the costliest office spaces in the emirate. As DIFC aims to create a unified international structure, the companies in the zone are required to conduct transactions only in US Dollars. These restrictions and requirements have been considered too rigid and have hampered the growth of the financial centre.

QFC has learnt from the experiences of DIFC and other financial centres and has, from the beginning, aimed to create an on-shore financial centre instead of an off-shore centre. This means that the companies in QFC can conduct transactions freely with companies outside the zone. The QFC licensed companies are allowed to operate from anywhere in the country as long as they conform to certain minimum requirements. This ensures that the companies are not bound to a specific area but operate from places that suit their budget and operations. Business can be conducted either in the domestic currency, Qatari Riyals, or in US Dollars as per the choice of the company. This helps the companies to indulge in both local and overseas transactions. However, it could be perceived, as some of the interviewees suggested, that the operations of businesses associated with the QFC are in direct competition with local businesses.

6.5.2 Avoidance of Over-Regulation

The regulatory structure created by QFC and DIFC have been borrowed from well-known regulatory structures already existing in international financial centres such as London. However it has been stated that these agencies have taken the most difficult provisions from the developed economies in their attempts to create the safest business environment. This is evident from the words of Philip Thorpe, the CEO of QFC who states that, "I would term ourselves as 'experienced plagiarisers': we have looked at different legislation and regulatory solutions around the globe and have cherry-picked the best ones" (Aaron, 2007). By 'cherry-picking' the best regulations from around the world QFC, like DIFC, has created a regulatory environment which is quite against the interest of the companies operating in the centre. International Law firm, Simmons & Simmons suggests that, "The people who have drafted the regulations have looked at other jurisdictions around the world and have taken the most heavily-regulated jurisdictions and applied it rather than recognising that we are in an emerging market and need to take baby steps" (Business Intelligence Middle East, 2009).

The regulatory environments in centres such as London and New York have reached the present stage through a process of evolution which has kept pace with the developments in the financial sector. However, in a country like Qatar, where financial services other than banking are at nascent stages, subjecting them to the regulatory requirements of advanced economies could prove to be counter-productive. This is an important lesson that QFC has to learn from DIFC, which has also incorporated tough regulatory requirements which the firms find difficult to comply with.

6.5.3 Unified Regulator

QFC is regulated by QFC Regulatory Authority that was created by a special order and statute of the Emir of the country, called QFC Law. QFC Regulatory Authority has sweeping powers to supervise, license and regulate all firms within the QFC jurisdiction. This includes banks and insurance companies. In addition to this the banks and intermediaries incorporated outside the QFC are regulated directly by agencies that fall under the Qatar Central Bank. This diverging structure has been adopted from the structure created for DIFC. However, unlike the DIFC, the firms in QFC are allowed to operate as on-shore finance companies, which permit them to access the same clients and resources as the other companies licensed by the country's Central Bank.

This, as mentioned earlier in the study, creates a dichotomy in regulatory structure as the two regulators are known to have different rules and requirements and have varying levels of severity in their approaches. The government has already recognised the need to unite the regulators under a single authority and implement uniform regulatory procedures. Even though it has been stated that "Qatar can be a viable financial centre only if the business climate in its entirety is modernised and placed under an overall authority" (Perumal, 2008), the government has come to realise that the task is difficult to carry out under current global economic circumstances. The IMF's Staff Report on the issue states that unification of regulatory structures could be quite challenging. Subsequently, the plans for unification have been put on hold. It is difficult to speculate on the effects of this on the progress of QFC especially as the issue of regulation is one of the major challenges facing financial sector development.

6. 6 Conclusion

The creation of Qatar Financial Centre is an acknowledgment that the domestic financial sector does not have the ability to contribute significantly to the government policy of economic diversification. It has been made clear from the data and analysis presented in this chapter that the sector has changed and its role has grown in the economy, however its contribution remains limited in the three significant measures of diversification: share in GDP, employment generation and private sector expansion. This could also be contributed to the fact that a shift in an economy dominated by the hydrocarbon industry needs more time to effect such substantial changes.

Thus, Qatar Financial Centre has been touted as an important development in Qatar's economy and a contributor to the growth of the country's finance sector and its GDP. This is due to the number of crucial roles that the centre is expected to perform: as an enabler of economic diversification, by attracting the interest of foreign financial institutions into Qatar's nascent domestic finance sector and the greater region, by promoting brand Qatar and attracting FDI inflows into the finance sector and other sectors in the economy and lastly by elevating Qatar's transparency and governance standards and regulatory environment akin to the home regulatory environment in which the target institutions already operate. So far QFC has attracted 115 members and its short history makes it difficult to make any valid judgement on its expected success or failure. To increase its chances of success and in order to differentiate itself, QFC has learnt or has to learn a few important points from its peers. QFC has observed the problems associated with being a pure-breed off-shore finance centre and so has been created as an on-shore finance centre right from the beginning. Also it has learned from the frictions seen in DIFC that over-regulation could become a problem considering the nascent nature of finance sector in the country. However, being an on-shore centre, its present system of multiple regulators of the financial sector is expected to cause a dichotomy and regulatory risk for institutions especially as the government's plan to unite the regulators under a single mandate has been put on hold.

An important point to consider is the ability of this nascent domestic sector to compete with the type of institutions that the financial centre is expected to attract. The limited domestic market and small population size, especially considering the large blue-collar workers in the economy, limits demand and the possibility of the sector to increase its contribution to economic diversification be it through increased share in the GDP or expansion in the private sector. It might be more prudent to create Gulf financial institutions by joint ventures and mergers that can enter the regional and international markets as competitors to well established international players, rather than give the opportunity to those international players to enter the region through the platforms of financial centres. For the long-term economic viability of Gulf States, developing GCC financial companies and institutions that already operate in the market might be the more prudent approach.

Chapter Seven

Conclusion

This study has demonstrated that the relationship between financial sector development and economic development is ultimately country specific. Contrary to the common position put forward in the mainstream literature, financial sector development in Qatar has followed its economic development and is conditioned by that development. In a hydrocarbon, one-sector economy, other economic sectors develop as a consequence of the growth and expansion of this main engine of growth. Over time the relationship becomes more dynamic and complex and interfaces among sectors start to be determined by a multiple of factors. In Qatar the financial sector is still nascent and its influence on the economy, although it has substantially increased over a short period of time, is still very limited. The markets of the developed countries took a long time to mature and to establish highly-complex and advanced financial services that have provided essential financial instruments and products to facilitate the growth of the economy as well as to service the different needs of customers. However, as the current crisis demonstrates the financial sector can also have devastating effects on the real economy in times of financial crisis.

The prospects for the growth of the financial sector are immense due primarily to the strength of Qatar's hydrocarbon industry and the planned extensive programmes of expenditure spearheaded by the government and its public sector in a multitude of sectors: infrastructure, tourism education etc., These extensive investments will increase demand on all types of financial intermediaries, especially insurance. This is an immense opportunity for Qatar to exploit in order to increase financial sector participation in the economy. Equally the challenges facing financial sector development are enormous and need addressing if the potential that exists in Qatar, and in the region as whole, is to be captured.

Key among these challenges is the lack of executives and managers who can handle the administration of public institutions that will steer that ambition, in addition to the lack of a local talent pool in financial services. Like other sectors in the economy there is a heavy reliance on foreign labour. All the interviewees suggested that investment in human capital and adopting the correct and effective training programmes is of utmost necessity for financial sector development and successful diversification. In addition there is a need for a cultural and attitudinal change from Qataris towards employment in the private sector; Qataris' employment is concentrated in the public sector. The rigidity in the labour market needs to improve and the dichotomy in the economy of public/private, Qataris non-Qataris needs to be removed. The modernization of the education system and the role of the QFC in enhancing training systems in financial services will be extremely beneficial to achieving such a necessary objective.

Nonetheless, changes of this nature take time and require the correct mix of educational and economic incentives. With young and fast growing national populations, job creation outside the public sector is a challenge faced by all GCC countries. It is also a big constraint on financial sector development as Michael Mainelli suggests, "Successful financial centres are places with strong concentrations of financial professionals and their firms'. It's the people that matter" (Lecture to Gresham College, London, 14 0ct 2009). Stuart Pearce, emphasising the importance of professionals says," We need all the good people we can get to achieve our goal establishing a viable financial centre for Qatar" (Interview, July 2008). He indicates that the uncertainty in London and New York might encourage talented people to move to the region. Qatar will depend on a pool of talent drawn from around the world to help in implementing its vision for financial sector development. But this needs to be a short-term outlook if Qatar is to create enough job opportunities for its nationals and establish a local capacity.

Also, as the study demonstrated, the potential that exists in Islamic finance (banking and *sukuks* and insurance) is immense. However, that also requires specialists and expertise in *Shariah* law to create the regulatory frame that clarifies procedures and identifies the financial instruments and products that are compliant with *Shariah* law. A legal frame that can protect investors needs to be put in place to maintain the credibility of the market. The recent events in Dubai of the possible defaulting of Dubai World on some of its *sukuk* issuance seem to emphasize this point.

Qatar's economic fundamentals remain strong despite the global financial crisis: a deep pool of liquidity and openness to international investors, both necessary for stimulating the development of the financial sector. Even so, successful financial centres such as Hong Kong and Singapore provide more than that; they provide a business environment: regulatory frame, a clear legal structure, physical infrastructure with well developed communications, transport, telecommunications and services. Qatar is investing heavily in order to improve and upgrade its business environment, but some of these aspects such as regulation, transparency and corporate governance are developing slowly. These issues can also be addressed more effectively within the GCC as they are common to most GCC countries and it would be more effective if they were addressed collectively.

The discussion has also demonstrated that the most effective way forward for implementing diversification strategy depends on the GCC speeding up their plans of integration, including monetary union. Over the years a great deal of lip service has been paid to the concept but little has happened on the ground. Competition and rivalry seems to be on the increase with the duplication of a large number of institutions and projects in a market that is too small to sustain such a multitude of similar companies. The current crisis in the global market, combined with very healthy forecasts for these economies, is a unique chance to capture a bigger share in the global market. While Europe, with its diversity of language, culture and economies is edging ever closer towards economic and political integration, the GCC, which enjoys the advantage of having similar linguistic and cultural attributes and faces similar economic challenges, is unable to move forward in its strategy and plans for economic integration. If Europe is able to set aside differences and focus on commonalities, then the task should be much easier within this comparable group of countries. Does the region really need three financial centres competing against each other? Dubai, Bahrain and Qatar could achieve more by increased cooperation among these centres rather than each vying for dominance.

During a recent conference organised by Qatar Chamber of Commerce and Industry in association with the GCC Chambers of Commerce and Industries on “The impact of the Financial Crisis on the Gulf States Economies” - experts and key people in the region called for a unified stance from GCC states during this global crisis, especially as it is thought that Gulf States are not disclosing the extent of the impact the crisis. The accumulative wealth of the hydrocarbon industry is helping them to cover the deficits. They also agreed on the necessity of encouraging merger plans across the GCC to enhance the resilience of their economies toward the crisis. Moreover, they acknowledged that the single Gulf Currency will open Gulf States to new opportunities of cooperation (Elshamy: 2009).

This crisis is in fact an opportunity for Gulf States to actualise their vision of many years for economic integration; there is a strong case as discussed in this study for the integration of stock markets, bond markets and merging financial companies to create more efficient and more competitive ones. Gulf States need to start acting not as individual states but in terms of an economic bloc- similar to Europe. That is where long-term sustainability and successful diversification lies for the GCC. The possibilities that such an eventuality can create far outweigh the benefits that the QFC can bring to the country.

However, it is very difficult, considering the short history of QFC, to make a judgment on the appropriateness of this model to achieve the desired objective of diversified and sustained development in Qatar. The question remains as to how much an increased role of international players operating from Qatar will achieve in terms of creating local capacity and imparting their skills and expertise into the local economy. Over the longer term, Qatar needs to ensure greater availability of a deep pool of skilled financial sector manpower domestically. This might not replace the need to tap talent from overseas but it will help develop local talent and address shortages of expertise. Reliance on foreign talent to meet the demand for expertise in specialist and management positions should be a short-term position. It is crucial to overcome gaps in manpower capabilities, not only in the financial sector in but all economic sectors. This will not eliminate the need for foreign talent but it will create diversified employment opportunities for nationals.

With the aggravation of unemployment in the Arab region, tapping into the talent that exists in the Arab region is crucial. It will on the one hand alleviate the problem in the Arab World and at the same time provide the needed labour from within the region for the benefit of the region. The Arab labour market needs to create 5.5 million job opportunities annually in order to tackle unemployment; however, only three million jobs have been created over the past two years. There are as many as 17 million jobless in the Arab world - 14 percent of the total workforce (Nainar: 2009). This is an alarming trend that could pose serious internal security and stability for many Arab states and the region as a whole. The Arab Economic Summit held in Kuwait during 2009 stated in its final communiqué that setting up the Arab Common Market in 2020 would go a long way toward solving this problem (*ibid*). The social and economic ills of this unemployment problem are compounded because of the lack of adequate social security in most Arab states. Thus cooperation in the Arab region is required on two levels, firstly, on a GCC level and then on an Arab region level, if the region is not going to waste another chance to create a more viable economic unity. There is a unique opportunity that must not be missed in the region to put aside political differences and follow the example of Europe to move forward in political and economic integration for the benefit of future generations in the region.

Bibliography

Books

Adam, N.J., and Thomas, A. (2004). *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk*. London: Euromoney Books

Al-Naqeeb, K.H. (1990). *Society and State in the Gulf and Arab Peninsula.* London: Routledge.

Beblawi, H. and Luciani, G. (1987). *The Rentier State.* London: Croom Helm.

Bryman, A. (1996). *Quantity and Quality in Social Research*. London: Routledge.

Creswell, J.W. (1994). *Research Design, Qualitative and Quantitative Approaches.* London: Sage.

Crystal, J. (1990). *Oil and Politics in the Gulf: Rulers and Merchants in Kuwaiti and Qatar*. Cambridge: Cambridge University Press.

Edward, E. S. (1973) *Financial Deepening in Economic Growth*. Oxford University Press

El Mallakh, R. (1979). *Qatar: Development of an Oil Economy*. London: Croom Helm.

El Mallakh, R. (1985) *Qatar: Energy and Development.* London: Croom Helm.

Frank, R.H., Bernanke, B. and Kaufman, R.T. (2007). *Principles of Economics.* Boston: McGraw Hill/Irvin.

Grummitt, J. (1980) *A Guide to Interviewing Skills*. London; Industrial Society

Harik, I. and Sullivan D.J. (1992). *Privatization and Liberalization in the Middle East.* Bloomington: Indian University Press.

Kandah, A.S. (2002). Impact *of the GATTs on the Competitiveness of the Qatari Banks 1995-2001*. Qatar Central Bank.

Kassem, M.S. and Ghazi, M.H. (1989). *Strategic Management of Services in the Arab Gulf States: Company and Industry Cases.* Berlin: Walter de Gruyter & Co.

King, G., Keohane, R. and Verba, S. (1994), *Designing Social Inquiry.* Princeton, New Jersey: Princeton University Press.

King, R. and R. Levine (1993), 'Financial Intermediation and Economic Development', *in Financial Intermediation in the Construction of Europe*, Eds, C. Mayer and X. Vives, London: Centre for Economic Policy Research, pp. 156-189.

Kubursi A.A (1984). *Oil Industrialization and Development in the Arab Gulf States.* London: Croom Helm.

Luciani, G., (ed). (1990). *The Arab State.* London: Routledge.

Mahdavy, H. (1970). "*The Patterns and Problems of Economic Development in Rentier States: the Case of Iran*", in Cook, M. (Ed.), *Studies in the Economic History of the Middle East from the Rise of Islam to the Present Day.* New York and Oxford: Oxford University Press.

Mansur, A. and Delgado, F. eds. (2008). *Stock Market Development in the Countries of the Gulf Cooperation Council.* Basingstoke: Palgrave Macmillan. Limited

May, T. (2001). *Social Research Issues, Methods and Process.* Maidenhead: Open University Press.

Nafi, Z.A. (1983). *Economic and Social Development in Qatar.* London: Frances Printer

Niblock, T. and Murphy, E. (1993). *Economic and Political Liberalization in the Middle East.* London: British Academic Press.

Presley, J. and Wilson, R. (1991). *Banking in the Arab Gulf.* London: Macmillan.

Stevens, P. (1989). *Privatization in the Middle East.* Surrey Energy Economics Centre, University of Surrey.

Suleiman, E.N. and Waterbury, J. (1990). *The Political Economy of Public Sector Reform and Privatization.* Boulder: Westview Press.

Wengraf, T. (2001) *Qualitative Research Interviewing.* London: Sage.

Wilson, R. (1983) *Banking and Finance in the Middle East*. New York: St. Martin's Press.

Wilson, R. (1987). *Gulf Trade and Finance: Trends and Market Prospects.* London: Graham & Trotman.

Zahlan, R.S. (1979). *The Creation of Qatar.* London: Croom Helm.

Zahlan, R.S. (1978). *The Origins of the United Arab Emirate: A Political and Social History of the Trucial States*. New York: Macmillan

Zahlan, R.S. (1998). *The Making of Modern Gulf States, Kuwait, Bahrain, Qatar, the United Arab Emirates and Oman*. Reading: Ithaca Press

Seznec, J.F. (1987). *The Financial Markets of the Arabian Gulf.* London: Croom Helm.

Journals

Abdulrazag, B., Shotar, M.M. and Al-Quran, A. (2003). *Money Supply in Qatar: An Empirical Investigation*. Journal of Economic & Administrative Sciences, Vol. 18, No. 2, pp. 118-126.

Aissaoui, A. (2009, 1 June). *The Challenges of Diversifying Petroleum Economies: Algeria in the Context of the Middle East and North Africa.* Middle East Economic Survey, Vo. LII, No 22.

Al-Abdulla, S.M. and Al-Khatib, F. (2001, September). *The State of Qatar: A Financial and Legal Overview.* Middle East Policy, Vol. VIII, No.3.

Al-Muharrami, S., Matthews, K and Khabari, Y. (2006). *Market Structure and Competitive Conditions in the Arab GCC Banking System.* Journal of Banking and Finance.

Al-Muharrami, S. (2009). *Analysis of Competitiveness in Qatar Banking Industry.* International Journal of Business Innovation and Research, Vol. 3, No. 2, pp 168-181.

Al-Muharrami, S. and Mathews, K (2009, May). *Market power versus efficient-structure in Arab GCC banking.* Applied Financial Economics

Ariss, R.T., Rezvanian, R. and Methdian, S. M. (2007). *Cost Efficiency, Technological Progress and Productivity Growth of Banks in GCC Countries.* International Journal of Business, Vol. 12, No. 4.

Bakheet, B. (1999, February). *Developing GCC Stock Markets: The Private Sector Role.* Middle East Policy Council, Vol. V1, No. 3.

Bank Audi (2008, July). *Qatar Economic Report.* Audi Saradar Group.

Beck, T. and Webb, I. (2003). Economic, Demographic and Institutional Determinants of Life Insurance Consumption across Countries. The World Bank Economic Review, Vol. 17, No.1, pp.51-88.

Berrebi, C., Martorell, F. and Tanner, J. C. (2009, Summer). Qatar's Labor Markets at a Crucial Crossroad. Middle East Journal, Vol. 63, No.3.

Bley, J. and Chen, K.H. (2006, 17 January). *Gulf Cooperation Council Stock Markets: The Dawn of a New Era.* Global Finance Journal, pp 75-9

Calderon, C. and Liu, L (2003). The *Direction of Causality between Financial Development and Economic Growth.* Journal of Development Economics, Vol. 72, No.1 pp 321-334.

Chaudhry, K.A. (1994, October). *Economic Liberalization and the Lineages of the Rentier State.* Comparative Politics, Vol.27, No. 1, pp.1-25.

Demetraides, P.O. and Hussein K.A. (1996). *Does Financial Development Cause Economic Growth? Time series Evidence from 16 Countries.* Journal of Development Economics, Vol. 51, No. 2, pp 387-411.

Dusuki, A.W. (2008). *Understanding the Objectives of Islamic Banking.* International Journal of Islamic & Middle East Finance & Management. Vol.1, issue 2.

Eid, F. (2006, July). *Private Equity Finance as a Growth Engine: What it Means for Emerging Markets.* Business Economics, pp 7-22.

El-Mefleh, M. and Shotar, M. M. (2008) *A Contribution to the Analysis of the Economic Growth of Qatar*. Applied Econometrics and International Development, Vol. 8, No. 1, pp 147-154.

Fasano, U. and Iqbal, Z. (2003) *GCC Countries: From Oil Dependence to Diversification*, International Monetary Fund

Gibbons, R. (2007, June). *The Global Market Comes of Age*. International Quarterly, Vol.2, Vol. 14.

Iqbal, Z. (1997, June). *Islamic Financial Systems*, *Finance and Development.* World Bank Publication, Oxford University Press.

Islam, M.M. (2003). *Development and Performance of Domestic and Foreign Banks in GCC Countries.* Managerial Finance, Vol. 29, No. 2/3.

Jaber M. (2000, February) '*GCC Financial Markets and The Quest for Development*' Middle East Policy, Vol. 7, No. 2, pp 20- 46

Jung, W.S. (1989, January). *Financial Sector Development and Economic Growth: International Evidence.* Economic Development and Cultural Change, Vol.34, No. 2, pp.333-346.

Kamrava, M. and Mora, F. O. (1998). *Civil society and democratisation in comparative perspective: Latin America and the Middle East.* Third World Quarterly, Vol. 19, No. 5, pp 893-916

Kamrava, M. (2009), "*Royal Factionalism and Political Liberalization in Qatar*." The Middle East Journal, Vol. 63, No. 3 pp. 401-420.

Khan, M. and Bhatti, I. (2008). *Development in Islamic Banking: a Financial Risk Allocation Approach*, The Journal of Risk Finance, Vol. 9, No.1, pp 40-51.

King, R.G and Levine, R. (1993), *Finance and Growth, Schumpeter Might be Right.* Quarterly Journal of Economics, Vol, 108, No. 3, pp. 717-57

King, R.G. and Levine, R. (1993). *Finance, Entrepreneurship and Growth: Theory and Evidences.* Journal of Monetary Economics, Vol. 32, No. 3, pp 513-542.

Levine, R., Loayza, N and Beck, T. (2000). *Financial Intermediation and Growth: Causality and Causes*, Journal of Monetary Economics. Vol. 46, pp31-77.

Levine, R. (1997). *Financial Development and Economic Growth: Views and Agenda.* Journal of Economic Literature, Vol. xxxv, pp. 689-726

Lynch, D. (1996). *Measuring Financial Sector Development: A Study of Selected Asia-Pacific Countries.* The Developing Economies, Vol. XXXIV, March, pp. 3-33.

MEED (2009, July). *The Resurrection of the Bond Market*, Vol. 53, No 30, pp. 24-30.

Miller, M.H. (1998, Fall) *Financial Markets and Economic Growth.* Journal of Applied Corporate Finance, Vol. 11, No 3.

Okruhlik, G. (1999) "*Rentier Wealth, Unruly Law, and the Rise of Opposition: The political Economy of Oil States" Comparative Politics*, Vol. 31, No. 4, pp. 295-315

Pansar, J. C. and Rosse, J. N. (1987). *Testing For "Monopoly" Equilibrium.* The Journal of Industrial Economics, Vol. 35, No. 4, pp. 443-456.

Patrick, H. (1966). *Financial Development and Economic Growth in Underdeveloped Countries*. Economic Development and Cultural Change, Vol. 14, pp 174-189.

Shirai, S. (2004). *Testing the Three Roles of Equity Markets in Developing Countries: the Case of China.* World Development, Vol. 32, No. 9, pp 1467-1486.

Snowden, P.N. (1997, October). *Enterprise Ownership Constraints and the Role of Equity Markets in Financial Development.* The Journal of Development Studies, Vol.34, No.1, pp.131-148.

The Economic Research Forum for the Arab Countries, Iran and Turkey (2002). *Economic Trends in the Mena Region.* Cairo and New York: The American University in Cairo Press.

Tsen, W.H. (2007). *Exports, Domestic Demand and Economic Growth: Some Empirical Evidence of the Middle East Countries.* Journal of Economic Cooperation, Vol. 28, 257-82.

Vaithilingam, S., Nair, M. and Samudra, M. (2006 Spring). *Key Drivers for Soundness of the Banking Sector: Lessons for Developing Countries.* Journal of Global Business and Technology, Vol. 2, No. 1, pp. 1-11.

Reports

Al-Sowaidi, S.S. and Darrat, A.F. (2006). *Financial Innovations and the Stability of Long-Run Money Demand: Implications for the Conduct of Monetary Policy in Three GCC Countries.* Conference Paper, ERF 13th Annual Conference.

Al-Sulaiti, K.A. Al-Khulaifi, A and Al-Khatib, F. (2000). *Banking Services and Customers' Satisfaction in Qatar: a Statistical Analysis.* Working Paper, College of Business and Economics, Qatar University.

Atkinson, A. (2009, 13 February) *Country Review:* Qatar. Euler Hermes.

Awad, T. and Al-Sowaidi, S. (2000). *Effectiveness of Monetary and Fiscal Policies: the Case of Qatar.* Working Paper, College of Business and Economics, Qatar University

Branard, L. (2008). *What is the Role of Insurance in Economic Development?* Zurich Financial Services.

Brown, K. (2003). *Islamic Banking Comparative Analysis.* The Arab Bank Review, 5, 2 43-50.

Creane, S, Goyal, R., Mushfiq Mobarak, A. and Sab, R. (2004). *Financial Sector Development in the Middle and North Africa.* International Monetary Fund, Working Paper WP/04/201.

Daouk, O. (2007, 25 April) *Analysis of the Sukuk Market*. Dubai: Shuaa Asset Management, Shuaa Capital.

Dekle, R. and Kletzer, K.M. (2001). *Domestic Bank Regulation and Financial Crises: Theory and Empirical Evidence from East Asia.* NBER Working Paper No. W8322.

Diab, N. A., Boustany, L.G. and Sayegh, E. (2004). *MENA- GCC Securitisation Market Review*. N.A.Diab and BSEC Berno Securitisation SAL.

Economic and Social Commission for Western Asia (1995). *Privatization in the Gulf Countries.* United Nations, Lebanon.

Edo, M.E. (1975). *Currency Arrangements and Banking Legislation in the Arabian Peninsula.* International Monetary Fund, Staff Papers, 22, 2 510-538.

Ehteshami and Wright, ' *Political Liberalization in the Arab Oil Monarchies'* p. 922

El-Naggar, Said *(ed.)* (1993). *Economic Development of the Arab Countries.* International Monetary Fund. Washington, DC

Ernest and Young (2009), *World Takaful Report 2008.*

ESCWA (1996). *Survey of Economic and Social Developments in the ESCWA Region: Privatization in the ESCWA Region.* E/ESCWA/ED/1996/3/Add.1. United Nations, Lebanon.

ESCWA (1997) *Role of Financial Markets in Privatization in the ESCWA Region.* E/ESCWA/ED/1997/3 United Nations, Lebanon

Fasano, U. and Iqbal, Z. (2003) *GCC Countries: From Oil Dependence to Diversification* . Washington: International Monetary Fund.

Favara, G. (2003): *An Empirical Reassessment of the Relationship between Finance and Growth*, IMF Working Paper, WP/03/123

First Finance Company (2002), Annual Report, Qatar.

First Finance Company (2004), Annual Report, Qatar.

First Finance Investment Company (2007) Annual Report, Qatar.

Haron, A. (2008). *Globalization in Islamic Capital Market Instruments*, Islamic Financial Services Industry.

Hassan, H. (2008, 25 June). *Challenges in Structuring Sukuk Issues*, London: 2008 Sukuk Summit.

Herring, R. and Santomero, A.M. (2008). *The Role of the Financial Sector in Economic Performance.* Wharton School of the University of Pennsylvania, Working Paper 95-08.

Ithmar Capital (2007). *The Impact of Private Equity on the GCC.* Dow Jones and Company. Dow Jones Private Equity, Commodity Quay, East Smithfield, London

Koren, M. (2007). *Volatility, Diversification and Development in the Gulf. Princeton University and CEPR*

Moody's Special Comment (2006, August). *Takaful: A Market with Great Potential*. Moody's Investor Services.

Moody's Special Comment (2008 *Middle East Insurance Sector Continued Strong Expansion*, February). Moody's Investor Services.

Murjan, W. and Ruza, C. (2002). *The Competitive Nature of the Arab Middle Eastern Banking Markets.* International Advances in Economic Research, 8, 4 267-274.

Nonneman, G. (1993). *Economic Liberalization in the Developing World: the State Debate and the Case of the Middle East.* University of Exeter: RUSEL Working Papers.

Qatar Central Bank (2001).*The Twenty Fifth Annual Report*

Qatar Country Profile (2007) London: The Economist Intelligence Unit.

Qatar Development Bank (2008). Annual Report.

Qatar Insurance Companies (2004) Annual Report, Qatar.

Qatar Insurance Companies (2005) Annual Report, Qatar.

Qatar Insurance Companies (2006) Annual Report, Qatar.

Qatar Insurance Companies (2007) Annual Report, Qatar.

Qatar National Bank(2009, May) *Qatar Economic Review*.

Qatar National Vision. (2008). General Secretariat for Development Planning, Doha, Qatar.

Qatar Today (2009 April).

Qatar Today (2009, July).

Qatar Today (2009 August).

Qatar Today (2009, September).

Quaden, G. (2007, 28 June). *Financial Sector Development and the role of Central Banks in Securing Financial Stability in a Globalised Economy.* Opening address at the 2007 International Arab Banking Summit, Brussels, BIS Review 75/2007.

Sarasathi, V. (2007, November). *Local Experts, International Expertise.* Qatar Today.

Thomas, A. and Muhamed Becic, Sh. (2007, December). *Are Sukuk Islamic? The Sukuk Market.* Shape Financial Corp. Report.

The Economist Intelligence Unit (2007). *Qatar Country Profile.* London.

The Report, Qatar (2009). Oxford Business Group.

The Twenty Fourth Annual Report (2000) Qatar Central Bank.

The Banking and Financial System in Qatar (1985). Qatar Monetary Agency.

The Banking and Financial System in Qatar (1992). Qatar Monetary Agency.

The Banking and Financial System in the State of Qatar (2002). Qatar Central Bank.

Twenty Seventh Annual Report (2003) Qatar Central Bank.

USAID (2006, February 15). Assessment on How Strengthening the Insurance Industry in Developing Countries Contributes to Economic Growth.

Wilson, R. (2006). *Innovation in the Structure of Islamic Sukuk Securities.* 2nd Banking and Finance International Conference, Islamic Banking and Finance, Beirut, 23-24 February 2006.

Web sources

AME INFO (2006 13 February). *First Corporate Islamic Bond for Qatar. http://ameinfo.com/cgibin.cms/page=print;link=77771. Date accessed 05/04/2008.*

AME INFO (2008, 06 March). *Amwal Showcases the Role for Investment Banking Firms in Real Estate During Forum.* http://ameinfo.com/149022.html. Date accessed 15/12/2008.

AME INFO (2008, 25 March). *Amwal Launches Marketing of the First Shari'a Compliant Real Estate Fund*. http://ameinfo.com/cgibin.cms/page=print;link=150998. Date accessed 16/12/2008.

AME INFO (2008, 29 June). *Amwal Launches Qatar Chlorine Equity Private Placements.* http://ameinfo.com/cgibin.cms/page=print;link=161890. Date accessed 16/12/2008.

AME INFO (2009, 25 January). *2008 Sees Worst Decline in Sukuk Market, Improvement in Islamic Syndicated*. http://ameinfo.com/182352.html. Date accessed 06/02/2009.

AME INFO (2008, July 6) *Amwal Signs Agreement with Doha Insurance for Mutual Cooperation.* http://ameinfo.com/cgibin.cms/page=print;link=162607. Date accessed16/12/2008.

Arnold, Tom (2009, 22 February). *Reeling from Huge Losses to Global Stock Markets, Gulf Financiers are Returning their Attention and Capital to their Home Economies.* Arabian Business, http://www.arabianbusinesses.com/547333-happy-returns?start=0. Date accessed 28/11/2009.

BBC (2009). *Country Profile: Qatar.* http://news.bbc.co.uk/2/hi/middle_east/country_profiles/791921.stm. Date accessed 10/08/2009.

Bladd, Joanne (2009, 30 September). *Gulf to Play Key Role in Future Global Finance.* Arabian Business, http:/arabianbusiness.com/569006?tmpl=print&page=. Date accessed 26/11/2009.

Blominvest Bank (2008). *Commercial Banking in the MENA Region.* http://www.blominvestbank.com/Library/Files/pdf/Commercial%20Banking51.pdf. Date accessed 10/08/2009.

Chartered Financial Analysis (2007, September). *Sukuk: A Global Trend.* http://www.iirating.com/presentation/200709-article-analyst-magazine.pdf Date accessed 12/08/2009.

Economic Times (2009, 28 November). *Singapore may be the New Financial hub.* http://www.timeslog.indiatimes.com/timeslog.dll/topcnt?HUR=economictimes. Date accessed 2/12/2009.

Economy Watch (2009). Econ Stats: Economic Statistics and Indicators for Qatar, for the Year of 2008. http://www.economywatch.com/economic-statistics/country/Qatar/. Date accessed 10/08/09.

Financial Times (2009, 27 November). *Dubai Reveals the Fragility of Finance.* http://ft.com/cms/308e52b0-db8c-11de-9424-00144feabdc0,dwp_uuid=07f1b. Date accessed 30/11/2009.

Gulf Investment Corporation (2008, 18 March). *GIC and ARCH Capital Group Ltd. Announce Joint Venture.* http://www/gic.com.kw/newsDetails.jsp:jsessionid=da302e9ebc3558566?id=1002 . *Date accessed 27/11/2009.*

Gulf News (2007, 29 May). *Bancassurance Likely to Grow Aggressively in Mena Region.* http://hulfnews.com/business/banking/bancassurance. Date accessed 27/11/2009

Gulf News (2008, 13 May). *Qatar Needs More Diversification.* http://gulfnres.com/business/economy/qatar-needs-more-diversifcation-1.107627. Date accessed 04/12/2008.

Gulf Times (2008, 31 January). *Qatar Boost for Eco-City in China.* http://gulf=times.com/site/topics/printArticle.asp?cu_no2&item_no=199004&v. Date accessed 05/02/2008

Islamic Finance Asia (2008 , August/September) *Sukuk Strikes the Right Chord.* http://www.islamicfinanceasia.com/cover.php. Date accessed 06/02/2009

LIoyds, Speeches (2007, 28 June) http://www.Lloyds.com/news-Centre/Speeches.htm. Date accessed 27/11/2008

MEED (2009, 6- 12 February) Special Report Qatar. http://www.meed.com/issue-no-06-6-12-february-2009/66.issue. Date accessed 04/07/2009.

MENA Report (2009) 2008 Sees Worst Decline in Sukuk Market. http://menareport.com/en/buniess.Financial_Markets/239659/. Date accessed 06/02/2009

Middle East North Africa Financial Times (MENAFN) (2008, 24 August). *GCC to Drive Global Sukuk Market to $200b by 2010* http://www.menafn.com/qn_news_story_s.asp?StoryId=1093209151 Date accessed 06/02/2009.

New Horizon Islamic Banking (2007, 8 October). *GCC Sukuk Sales Surpass Malaysia.* http://www.newhorizonislamicbanking.com/index.cfm?section=breaknews&action. Date accessed 06/02/2009

Othman, S. H. (6/9/2010). *Qatar's Sustained Economy Helps QFC Edge over Rivals*, Doha. Biz, http://doha.biz/2009/10/06/qatars-sustained-economy-helps-qfc-edge-over-rivals/

PLC Finance (2006, 27 July). *First Sukuk Lists on London Stock Exchange.* http://property.practicallaw.com/1-203-6860. Date accessed 04/03/2008.

Qatar Central Bank (2002). *The Banking and Financial System in the State of Qatar.* http://www.qcb.gov.qa/English/Publications/Documents/BankingSysinQatar.pdf. Date accessed 10/08/09

Qatar Central Bank (2009a). *Quarterly Statistical Bulletin, March 2009.* http://www.qcb.gov.qa/English/Publications/Statistics/Documents/March-2009.pdf. Date accessed 10/08/09.

Qatar Central Bank (2009b). *Quarterly Statistical Bulletin, May 2009.* http://www.qcb.gov.qa/English/Publications/Statistics/Documents/Excel%20May%202009. Date accessed 10/08/09.

Qatar Central Bank (2009c). *Quarterly Statistical Bulletin, June 2009.* http://www.qcb.gov.qa/English/Publications/Statistics/Documents/Excel%20of%20June%202009.xls. Date accessed 10/08/09.

Qatar National Bank (2006). *Qatar Economic Review.* http://www.qnb.com.qa/csportal/BlobServer?blobcol=urlenglishdoc&blobtable=QNBNewDocs&blobkey=id&blobwhere=1193211039623&blobheader=application%2Fpdf. Date accessed 10/08/09.

QNB Capital (2009). *Banking Sector Review.* http://www.qnb.com.qa/csportal/BlobServer?blobcol=urlenglishdoc&blobtable=QNBNewDocs&blobkey=id&blobwhere=1246522749310&blobheader=application%2Fpdf. Date accessed 10/08/09.

Raphaeli, Nimrod (2007, 21 September. The Growth of the Sukuk Market in the GCC Countries. http://memrieconomicblog.org/bin/content.cgi?article=28. *Date accessed 06/02/2009.*

Reuters (2007, 27 March). *Gulf 2007 Corporate Bond Issuance to Double.* http://reutters.com/article/oilRpt/idUKL273929862007327. Date accessed 04/04/2008.

Setser, B. (2008). *The Great Emerging Market Inflation of 2007 and 2008.* RGE Monitor, http://www.rgemonitor.com/setsermonitor/246016/the_great_emerging_market_inflation_of_2007_and_2008. Date accessed 10/08/09.

Sigma Report, No.5/2008. Swisse Re (2008). Analyzes Emerging Markets, Takaful http://www.swissre.com/pws/research%20publications/sigma%20ins.%20research/sigma%20archive/sigma_archive_english.html. Date accessed 28/10/2008

The Economic Times (2009, 28 November). *Singapore may be the New Financial Hub.* http://timeslog.indiatimes.com/timelog.d11/topcnt?CHUR=economictimes. Date accessed 2/12/2009.

The New York Times (2009 03 September). *Qatar Props up its Banking System.* http://www.nytimes.com/2009/03/09/business/09iht-riyal.4.20707372. Date accessed 26/10/2009.

UBS Investment Bank (2008, November). *The Soaring of Sukuk Market.* http://www.ftbusinessevents.com/islamicsummit2008/images/contentpage/ismail%20dadabhoy%20-%20presentation.pdf. Date accessed 26/10/2008

Zawya (2008 14 January). *Qatar to Lead GCC in Corporate Bonds.* http://ww.Zawya.com/Story.cfm/sidZAWYA20080114105736/SecMain/pagHomep Date accessed 04/04/2008.

Zawya (2008, 13 April). *Gulf Re Targets High Value Energy pro*jects. http://ww.Zawya.com/printstory.cmf?storyid-ZAWYA20080413033714&1-033700. Date accessed 27/11/2008.

Zawya (2008, October) *Unification will Enhance Qatar's Reputation.* http://ww.Zawya.com/printstory.cmf?storyidZAWYA20081008074600&1=07460081008. Date accessed 1/4/2009

Newspapers

Barber, T. and Parker, G. (2007, 27 September). *Call for Clarity on Wealth Funds*. Financial Times.

Blas, J. (2007, 13 November). *Oil's Troubled Water: Sovereign Wealth Funds Move into Commodity Investment.* Financial Times,.

Brown, A. (2007, 3 December). *The Middle East: The Boom Continues.* Financial Times.

El Shamy, A. (2009, 16 April). *Expedite Monetary Union Plan.* Gulf Times.

Financial Times (2008 31 January). *Qatar Boost for Eco-City in China.*

Ibison, D. (2008, 5 December). *Qatar Bows Out of OMX B*attle. Financial Times.

Kay, J. (2008, 26 February). *Sovereign Wealth is a Force for Stability.* Financial Times.

Kerr, S. (2007, 12 September). *Gulf Arabs Flex Muscles for Global Buy-Out as Funds Gain Confidence.* Financial Times.

Kerr, S. (2007, 19 September). *Qatar Optimistic on Credit for Fund.* Financial Times.

Kerr, S. (2007 23 October). *Qatar 2007: An Appetite for Acquisition.* Financial Times.

Kerr, S. (2007, 19 November). *Sovereign Wealth Funds: Power Magnifies as Petrodollar Gains Ground.* Financial Times.

Kerr, S. (2008, 24 January). *Gulf Tipped to Ride Wave of Soaring Prices.* Financial Times.

Kerr, S. (2009, 29 November). *UAE Push to Head Off Debts Damage.* Financial Times.

Kerr, S. and Wigglesworth, R. (2009, 30 November). *Dubai Rejects Guarantee for Dubai World.* Financial Times.

Kerr, S. (2009, 1 December). *No State Guarantee for Dubai World.* Financial Times.

Khalaf, R. (2007a, 19 November). *Boomtime in Lands of Oil and Money.* Financial Times.

Khalaf, R. (2007b, 19 November). *Gulf Arab Funds Eye US Assets,* Financial Times.

Nainar, M. (2009, 16 April). *Alarm at Unemployment Rate.* Gulf Times.

Parker G. and BarberT. (2007 27 September). *Call for Clarity on Wealth Funds.* Financial Times.

Parker, J. & Arnold, M. (2007, 5 December). *Britain Open to Business from Sovereign Wealth Funds.* Financial Times.

Perumal, S. (2008, 23 January). *QFC Must Report Members' Financials to QCB.* Gulf Times.

Salem, M. (2009, 21 March). *Qatar Buys QR6.5bn of Bank Investments.* The Peninsula.

Sen, P. (1986). *The 1966 Devaluation in India: A Reappraisal.* Economic and Political Weekly, 21, 30, 1322-29.

Sender, H. (2007, 24 July). *Qatar, in UK Play, Shows its Deal Thirst; Where to Put $1 billion.* Wall Street Journal.

Sender, H. (2008, 18 February). *Qatar Fund Buys Credit Suisse Stake.* Financial Times. *s Credit Suisse Stake.* Financial Times.

Teather, D. (2007, 21 July). *Gulf States Target Britain So They Can Invest Their Cash Beyond the Oil Fields.* The Guardian.

Tett, G. (2007, 22 November). *Gulf Liquidity Offers Glimmer of Hope.* Financial Times.

Tett, G. (2008, 24 January). *Davos: Sovereign Funds Face Growing US Pressure.* Financial Times

Tett, G. (2008, 8 February). *Western Banks Face Backlash as they Hand out Begging Bowl.* Financial Times.

The Daily Telegraph (2009, 22 May). *Qatar Fashions Financial Oasis to Go Toe-to-Toe with East and West.*

The Peninsula (2008, 14 January). *Qatar to lead GCC in Corporate Bonds.*

The Peninsula (2008, 27 September) *Qatar Tops in FDI Growth in MENA Region.*

Washington Times Global (2010, 27 June). *Qatar Emerging as a Key Financial Centre in the Gulf.*